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Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

DFA INVESTMENT DIMENSIONS GROUP INC., STATE STREET BANK & TRUST COMPANY, and PNC BANK, N.A.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 546(e) of the Bankruptcy Code excepts from a bankruptcy trustee's or debtor-in-possession's avoiding powers settlement payments made "by or to" one of five types of entities, including financial institutions. The court of appeals presumed that payments made to Petitioners in a leveraged buy out merger transaction in exchange for their stock were settlement payments and found that a financial institution was involved in the transaction. The court of appeals held that Section 546(e) did not preclude this action against Petitioners by the debtor-in-possession. The question presented for review is:

1. Whether Section 546(e) bars an action by a bankruptcy trustee or debtor-in-possession to recover settlement payments made to shareholders by a financial institution in a leveraged buy out merger transaction.

LIST OF PARTIES

Respondent, Munford, Inc., was the Plaintiff-Appellant in the appeal of this case to the United States Court of Appeals for the Eleventh Circuit.

In addition to Petitioners, the following parties also were Defendants-Appellees in that appeal: Danné Brokaw Munford, as Executrix of the estate of Dillard Munford, James M. Carroll, Russell C. Fellows, Joseph W. Hardin, Jay E. Rubel, Winton M. Blount, Herbert J. Dickson, James L. Ferguson, Robert M. Gardiner, Richard K. LeBlond, Andrall E. Pearson, S.B. Rymer, Jr., and Boston Safe Deposit Trust Company.

The United States Securities and Exchange Commission is a statutory party in bankruptcy reorganization proceedings under Section 1109(a) of the Bankruptcy Code, 11 U.S.C. § 1109(a) (1994). The Commission participated in the appeal in this case as Appellee, supporting Petitioners.

In addition to the foregoing parties, Valuation Research Corporation was a defendant in the case below, but was not a party to the appeal to the Eleventh Circuit.

Petitioner, DFA Investment Dimensions Group Inc. is a mutual fund group that manages numerous portfolios, i.e., mutual funds. These portfolios are identified in the Appendix at App. 113. DFA Investment Dimensions Group Inc. has no parent companies or nonwholly-owned subsidiaries.

Petitioner, State Street Bank & Trust Company, was sued in this action only in its capacity as the trustee of two DFA Group Trusts. Its parent company is State

Street Corporation. State Street Corporation and State Street Bank & Trust Company have the following nonwholly-owned subsidiaries: Boston Equiserve Limited Partnership; Three Heritage Drive Associates; Boston Financial Data Services Inc.; European Financial Data Services Limited; High Street Investments, Inc.; State Street Bank Luxemburg, S.A.; Newport Shopping Center Limited Partnership; and Wellspring Resources LLC.

Petitioner, PNC Bank, N.A., was sued in this action only in its capacity as the trustee of two DFA Group Trusts. PNC Bank, N.A., was named in the complaint in this case as Provident National Bank. In the appeal below, Provident National Bank sought and received leave from the court to change its name in this case to PNC Bank, N.A. after Provident National Bank was merged into Pittsburgh National Bank and the new entity was renamed PNC Bank, N.A. The immediate parent of PNC Bank, N.A., is PNC Bancorp, Inc., which in turn is wholly owned by the ultimate parent, PNC Bank Corp. PNC Bank, N.A. has no nonwholly-owned subsidiaries.

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PETITION FOR WRIT OF CERTIORARI

Petitioners, DFA Investment Dimensions Group Inc., State Street Bank & Trust Company, and PNC Bank, N.A., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eleventh Circuit in this case.

OPINIONS BELOW

The order of the United States Court of Appeals for the Eleventh Circuit denying the Suggestion for Rehearing *En Banc* (App. 112) is not reported. The opinion of the United States Court of Appeals for the Eleventh Circuit (App. 1) is reported at 98 F.3d 604 (11th Cir. 1996). The opinion of the United States District Court for the Northern District of Georgia (App. 23) is not reported. The opinion of the United States Bankruptcy Court for the Northern District of Georgia (App. 52) is not reported.

JURISDICTIONAL STATEMENT

On Respondent's appeal, the United States Court of Appeals for the Eleventh Circuit, on October 28, 1996, entered a judgment reversing the district court's order in part and remanding this case to the district court for further proceedings. On July 9, 1997, the court of appeals denied Petitioners' timely-filed Suggestion for Rehearing *En Banc*, which also serves as a petition for rehearing under Eleventh Circuit Rule 35-6. In that same order, the court of appeals denied the Securities and Exchange Commission's Petition for Rehearing With Suggestion for Rehearing *En Banc*.

This Petition for Writ of Certiorari is filed within 90 days of the court of appeals' July 9, 1997, order. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1) (1994).

STATUTORY PROVISION INVOLVED

This case involves Section 546(e) of the Bankruptcy Code, 11 U.S.C. § 546(e) (1994), which provides as follows:

§546 Limitations on avoiding powers

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in Section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

STATEMENT OF THE CASE

This case arises out of a merger transaction that took place in November 1988. Respondent, Munford, Inc. ("Munford"), as debtor-in-possession, sued Petitioners seeking to recover payments made to Petitioners in exchange for shares of Munford stock. Munford brought this action under Section 544 of the Bankruptcy Code, 11 U.S.C. § 544 (1994), and under the "constructive fraud" provision of the Georgia Fraudulent Conveyance Act, Ga. Code. Ann. § 18-2-22(3) (1991). The Bankruptcy Court recommended that Petitioners' motion for summary judg-

ment be denied. The district court rejected this recommendation, and entered an order granting Petitioners' motion for summary judgment. A divided panel of the Eleventh Circuit reversed, holding that Section 546(e) of the Bankruptcy Code does not bar this action.

A. *The Munford Leveraged Buy Out Merger*

The facts relevant to this Petition are undisputed and uncomplicated. For many years prior to the merger, Munford was a public company with its stock traded on the New York Stock Exchange.[1] At the time of the merger, approximately 3,100 shareholders owned the more than 3.9 million outstanding shares of Munford common stock.

Petitioner, DFA Investment Dimensions Group Inc., a mutual fund, and two DFA Group Trusts (hereinafter collectively the "DFA Entities") were three of those 3,100 Munford shareholders.[2] The DFA Entities owned 234,158 shares of Munford common stock. The DFA Entities invest funds primarily for the benefit of qualified pension, profit sharing, and other retirement plans. Most of the ultimate beneficiaries of their investment activities are retirees and pensioners of various companies. The DFA Entities' investment strategy focuses on extremely diversified holdings of small companies' stock for the

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[1] Munford operated 555 Majik Market convenience stores, primarily in the Southeastern United States, and a chain of World Bazaar specialty stores.

[2] Petitioners, State Street Bank & Trust Company and PNC Bank, N.A., are the trustees for the two DFA Group Trusts that owned Munford shares at the time of the merger.

long term. The DFA Entities attempt to acquire a portion of the common stock of all publicly-traded companies in a defined size range, based upon the value of the company's market capital. As a result, they hold title to the stocks of thousands of companies with the goal of achieving long-term appreciation. Consistent with this strategy, the DFA Entities acquired their shares of Munford stock gradually over a period of years beginning in 1982.

In May 1988, Munford's Board of Directors approved an agreement in principle between Munford and a group of new investors to acquire Munford by purchasing all outstanding shares of Munford stock. In August 1988, the Munford Board of Directors approved and executed the Merger Agreement, which included a purchase price of $17.00 per share of Munford stock. A Proxy Statement was sent to all Munford shareholders informing them that the Board of Directors recommended that they approve the merger.

The Merger Agreement set forth the terms and mechanics of the merger. To implement the transaction, the new investors created two companies: the Alabama Acquisition Corporation ("AAC"), and its wholly-owned subsidiary, the Alabama Merger Corporation ("AMC"). Pursuant to the Merger Agreement, Munford was obligated to proceed with the merger only if AAC or AMC deposited with Citizens & Southern Trust Company ("Citizens & Southern"), a financial institution, sufficient funds to purchase the stock owned by Munford's shareholders. (App. 56-57) The Merger Agreement provided that each share of common stock outstanding immediately prior to the merger would be converted into the right to receive the merger price of $17.00 per share. As the

Proxy Statement made clear, after the merger, old Munford's shareholders, including the DFA Entities, would possess no further ownership interest in Munford and would not participate in any future earnings and growth of the Company.

The merger was approved by Munford's shareholders, and it was closed on November 29, 1988. On that date, the new investors deposited in Citizens & Southern sufficient funds to purchase the stock of all Munford's shareholders.

The DFA Entities did not participate in the Munford merger's negotiation, planning, or implementation: they were strictly outside, minority shareholders. They had no communications about the merger with anyone connected with Munford, except for receiving the Proxy Statement. Thus, the DFA Entities were not privy to any inside, non-public, information involved in this transaction.

Prior to the merger, the DFA Entities' Munford stock certificates were held by Depository Trust Company ("DTC"). DTC is part of the nation's securities clearance and settlement system. On December 2, 1988, Morgan Guaranty Trust Company, custodian for the DFA Entities, directed DTC to surrender to Citizens & Southern the Munford shares owned by the DFA Entities and to receive the merger payment of $17.00 per share. DTC, through its nominee, Cede & Co., tendered these Munford shares to Citizens & Southern by deleting the stocks from its records and issuing a corresponding credit to Citizens & Southern. Simultaneously, Citizens & Southern credited DTC with the merger payments for the shares tendered. DTC deposited the funds in a Morgan

Guaranty account, which then credited the amounts received to the appropriate DFA accounts. (App. 81-82)

B. *Proceedings Below*

On June 17, 1991, Munford, acting as debtor-in-possession, filed this adversary action in the United States Bankruptcy Court for the Northern District of Georgia. This Petition addresses Count I of Munford's complaint, the only count that asserts a claim against the DFA Entities, in which Munford seeks to recover under Section 544(b) of the Bankruptcy Code, commonly referred to as the "strong arm" clause, the $3.9 million of merger payments the DFA Entities received for their shares of Munford stock. Munford seeks recovery solely under the "constructive fraud" provision of the Georgia Fraudulent Conveyance Act, Ga. Code Ann. § 18-2-22(3) (1991). No claim is made that the DFA Entities had any intent to defraud creditors or that they had any knowledge that the merger constituted an alleged fraudulent conveyance. The DFA Entities are the only outside shareholders sued in Count I.

Following extensive discovery, the DFA Entities filed a motion for summary judgment in the bankruptcy court on the ground that Munford's claim under Section 544(b) was precluded by the exception in Section 546(e) of the Bankruptcy Code. The bankruptcy court recommended to the district court that it deny this motion.

The district court rejected the bankruptcy court's recommendation and entered an order granting the DFA Entities' motion for summary judgment. The district court held that the merger payments made to shareholders through a financial institution acting as a clearing or

exchange agent were "settlement payments" within the meaning of Section 546(e). The court further determined that these settlement payments were made "by" a financial institution, and, thus, Section 546(e) precluded Munford's action against the DFA Entities to avoid these payments.

C. *The Court of Appeals' Decision*

A divided panel of the Eleventh Circuit reversed the district court's grant of summary judgment on Count I in favor of the DFA Entities, with Chief Judge Hatchett dissenting from that portion of the court of appeals' decision.[3] 98 F.3d 604 (11th Cir. 1996) (App. 1). The court of appeals began its analysis by describing the purpose of Section 546(e):

> Congress enacted section 546(e) "to minimize the displacement caused in the commodities and securities market in the event of a major bankruptcy affecting those industries." H.R. Rep. No. 97-420, 97 Cong., 2d Sess. 1 (1982), U.S.Code Cong. & Admin. News 583. With the passage of section 546(e), "Congress [also] sought to 'promote customer confidence in commodity markets generally' via 'the protection of commodity mar-

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[3] The district court also had entered summary judgment in favor of the Munford Board of Directors on Munford's claim that they had breached their fiduciary duty to the company in approving the merger and recommending that shareholders also approve the merger. The court of appeals affirmed that part of the district court's ruling, holding that the directors had acted in good faith and properly exercised their business judgment in an informed and deliberate manner. 98 F. 3d at 610-11.

> ket stability.'" *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (quoting Sen. R. No. 989, 95th Cong., 2d Sess. 8 (1978)).

(App. 9-10) The court of appeals then presumed that the merger payments made to Munford shareholders were "settlement payments" within the meaning of Section 546(e). (App. 12) The court of appeals nonetheless held Section 546(e) inapplicable because it determined that the settlement payment was not made "by or to" one of the entities listed in Section 546(e). (App. 12-13) The Eleventh Circuit acknowledged that a financial institution, one of the entities listed in Section 546(e), was involved in the transaction. However, the court found the financial institution never acquired a beneficial interest in the funds, and therefore believed that the financial institution was not a "transferee", as defined in Section 550 of the Bankruptcy Code, 11 U.S.C. § 550 (1994). The court of appeals concluded:

> [T]he shareholders were the only "transferees" of the funds here. And, of course, section 546(e) offers no protection from the trustees avoiding powers to shareholders; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies. Accordingly, regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities.

(App. 12-13)

Chief Judge Hatchett dissented from this part of the court of appeals' decision. He noted that Munford had deposited the funds to purchase its shares with Citizens

& Southern, a financial institution, and that Munford now sought to avoid the payments Citizens & Southern had made to shareholders. (App. 21) He stated that he believed the majority "chose to disregard the plain language of section 546(e) in order to create a new exception to its application." (App. 22) He concluded that Section 546(e) "only permits a trustee in bankruptcy to avoid settlement payments made to shareholders by a financial institution when such payments are made with actual intent to hinder, delay or defraud creditors." (App. 22)

REASONS FOR GRANTING THE WRIT

Review by writ of certiorari is a matter of judicial discretion that should be favorably exercised in those cases in which a conflict exists between or among the United States courts of appeals on an important federal question. Sup. Ct. R. 10(a). This case meets this requirement.

The decision of the court below conflicts with a previous decision of the United States Court of Appeals for the Tenth Circuit regarding the proper application of a provision of the Bankruptcy Code to leveraged buy out merger payments made by commodity brokers, forward contract merchants, stockbrokers, financial institutions, or securities clearing agencies to beneficial owners of securities. The court of appeals' decision presents an issue of substantial importance, because it permits a bankruptcy trustee (or debtor-in-possession), years after the sale of stock, to recover payments made to shareholders in a public merger transaction. This result will disrupt long-settled securities transactions and seriously

undermine confidence in the nation's securities markets. If review of the decision below is granted, that decision should be reversed because the court of appeals' construction of Section 546(e) is contrary to the plain and unambiguous language of the statute and inconsistent with Congress' purpose in enacting the statute.

I.

The Eleventh Circuit's Decision Is in Direct Conflict with a Decision of the Tenth Circuit

The Eleventh Circuit's decision in this case is in direct conflict with the Tenth Circuit's decision in *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). The court of appeals presumed that the payments to the shareholders were "settlement payments" within the meaning of Section 546(e), and recognized that a financial institution made the merger payments to the shareholders that the debtor was now seeking to avoid. Nonetheless, the court of appeals ruled that Section 546(e) did not protect shareholders from the trustee's avoiding powers because it erroneously held that Section 546(e) is only applicable to settlement payments made to one of the listed entities.

The Tenth Circuit reached the opposite conclusion in *Kaiser Steel*, which also involved payments to public shareholders in a leveraged buy out merger transaction. In the Kaiser Steel merger, the funds for the merger were deposited in Bank of America, a financial institution. 952 F.2d at 1235. After the effective date of the merger, Kaiser Steel shareholders were required to tender their shares to Bank of America in order to receive the merger payment. 952 F.2d at 1235. As with

the DFA Entities, most of the Kaiser Steel stock was in the possession of DTC. 952 F.2d at 1235. DTC tendered the Kaiser Steel stock to Bank of America, received the merger payments, and then transferred the payments to brokers or other financial intermediaries who disbursed the payments to the beneficial owners of the Kaiser Steel stock. 952 F.2d at 1235-36.

After filing for voluntary reorganization under Chapter 11 of the Bankruptcy Code, Kaiser Steel, as debtor-in-possession, sought to recover the merger payments from the shareholders who owned the Kaiser Steel stock tendered in connection with the merger. 952 F.2d at 1236. The shareholders argued that Section 546(e) barred Kaiser Steel's attempt to recover the merger payments. The district court agreed, and dismissed the claims. The Tenth Circuit affirmed.

The Tenth Circuit began its analysis by finding that the merger payments were "settlement payments" within the meaning of Section 546(e). 952 F.2d at 1237-40. The court of appeals then considered Kaiser Steel's argument that Section 546(e) does not protect a settlement payment "by" a stockbroker, financial institution, or clearing agency, unless the payment also was "to" another participant in the clearance and settlement system and not to a shareholder. 952 F.2d at 1240. The Tenth Circuit rejected this argument. It found that Section 546(e) was clear and, on its face, applied to settlement payments "by or to" a listed entity. 952 F.2d at 1240. The court of appeals refused to ignore the "unambiguous language" of the statute because the application of the language would not be absurd. 952 F.2d at 1241. Accordingly, the court held that Section 546(e) barred the claims against the shareholders.

The conflict between the decision below and the *Kaiser Steel* decision is clear. The courts of appeals addressed identical facts and came to opposite conclusions. Both cases involved the following factual circumstances:

1. The funds for a leveraged buy out merger were deposited by the purchasers in a financial institution.
2. The holders of the stock certificates—including in both cases DTC—tendered the certificates to the financial institution and received the merger payments.
3. The holders of the certificates then transferred the merger payments to the accounts of stockbrokers or other financial institutions.
4. The stockbrokers or other financial institutions then transferred the merger payments to the accounts of the shareholders who were the beneficial owners of the stock.

In both cases the debtor-in-possession sought to recover the merger payments from the shareholders, and the shareholders argued that Section 546(e) prevented such recovery. Both courts found that the merger payments to the shareholders constituted "settlement payments" within the meaning of Section 546(e). Nonetheless, at this point the two courts diverged. The Tenth Circuit held that Section 546(e) protected these settlement payments, rejecting the argument that the payments were not protected unless they were made to one of the entities listed in Section 546(e). The Eleventh Circuit held to the contrary, adopting the same reasoning expressly rejected by the Tenth Circuit. This Court should grant certiorari to resolve this conflict.

II.

Whether Section 546(e) Applies to Settlement Payments Made by a Financial Institution to Beneficial Shareholders Is an Important Federal Question

The court of appeals' decision presents an important national issue of substantial economic importance for individual investors, mutual funds, and the entire securities industry. It would permit a bankruptcy trustee (or debtor-in-possession), years after the sale of stock, to recover payments made to shareholders in a public merger transaction found to be properly recommended by the Board of Directors and approved by the shareholders. Such a recovery would undo long-settled securities transactions and undermine confidence in the nation's securities markets.

The Securities and Exchange Commission, a statutory party to this case in the court below, described the adverse consequences of the Eleventh Circuit's decision as follows:

> The effect of the panel majority's decision would be to inject uncertainty once again into the clearance and settlement system, thereby harming the system itself by subjecting its participants and investors to the risk that obligations will not be satisfied.

Petition of the Securities and Exchange Commission, Appellee, for Rehearing With Suggestion for Rehearing *En Banc* at 6, *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996) (No. 94-9046). By comparison, the Securities and Exchange Commission fully agreed with and supported the Tenth Circuit's decision in *Kaiser Steel*. In its brief to this Court, filed in opposition to Kaiser Steel's Petition

for Writ of Certiorari, the Securities and Exchange Commission stated:

> [The Tenth Circuit's] holding does not conflict with any decision of this Court or of any other court of appeals. Moreover, the decision is consistent with the plain language and purpose of the relevant Bankruptcy Code provision. Review by this Court is therefore not warranted.

Brief for the Securities and Exchange Commission in Opposition at 7, *Kaiser Steel Resources, Inc. v. Pearl Brewing Co.*, *cert. denied*, 505 U.S. 1213 (1992) (No. 91-1607).

The purchase and sale of securities in the national securities markets involves a number of participants, each of which undertakes obligations to other participants. The court of appeals' conclusion that sales of stock by the beneficial owners are not included within the statute ignores the fundamental fact that securities customers are key participants in the clearance and settlement system. Similarly, the Eleventh Circuit's reliance on the fact that the financial institutions in this case were acting as "conduits" ignores the fact that customers often use stockbrokers, financial institutions, and clearing agencies to facilitate their transactions.

Typically, a customer wishing to buy a security gives an order to a broker, who in turn purchases the security from another broker that has entered an order to sell the security for its customer. After the trade is initially agreed upon, the process that results in the ultimate delivery of the security in exchange for the purchase price is called "clearance and settlement."

This process is typically performed through a clearing agency or financial institution, with the broker for the seller being obligated to deliver the securities involved in the transaction to the clearing agency in exchange for payment of the purchase price. The broker for the buyer similarly is obligated to pay the purchase price when the securities are delivered to that broker. These obligations exist regardless of whether the person or entity on whose behalf the broker is acting fulfills its payment or delivery obligations to the broker. The failure of the customer who is buying securities to pay for them, for example, will not excuse the broker's obligation to deliver payment. Similarly, the broker for the seller must deliver securities, regardless of whether the broker itself receives delivery from the customer. Thus, even though brokers or financial institutions act on behalf of their customers, and may never have a beneficial interest in the securities, their participation is vital to the orderly operation of the nation's clearance and settlement system.

Allowing a debtor or bankruptcy trustee to reverse long-settled securities transactions would seriously disrupt this system and undermine investor confidence in the financial markets. It is important to investors (including mutual funds, retirement plans, and individual owners of stock) to have finality and stability in their securities transactions. If stockholders must worry that sales of their stock in public, above-board, arm's-length transactions are not final, substantial uncertainty among investors would result. Such uncertainty could de-stabilize securities markets and interfere with the market's ability to raise capital. The problem is exacerbated because mutual fund shareholders and group trust partici-

pants are different today than they were in 1988, so the shareholders who did not receive proceeds of the sale of a stock could be harmed if such a reversal occurred.

The diminished investor confidence that would result if long-settled securities transactions can be reversed also would create an environment hostile to capital formation. Moreover, the possibility that settled transactions can be reversed could result in greater volatility in the capital markets. Volatility is apt to increase as shareholders seek to dispose of their shares before the effective date of an LBO in order to avoid any possibility that they would be required to return the LBO proceeds in the future. As former SEC Commissioner Bevis Longstreth testified at the Congressional hearing on the enactment of Section 546(e): "A failure to perform by any participant in the chain of transactions can have serious adverse consequences for the remaining participants. Thus, the liquidity of the system is dependent upon the assumption by each participant that all of the others will perform." *Bankruptcy of Commodity and Securities Brokers: Hearings before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 97th Cong. 239 (1981).

This case, which involves payments to a mutual fund and group trusts—major customers and participants in the securities clearing system on a daily basis—presents a graphic illustration of the wisdom of Congress's approach. The DFA Entities are regular participants in the securities markets and the beneficial owners of the securities (the DFA Entities actually own the securities for the benefit of their own participants, primarily retirement plans, and in that sense, are not the final beneficial owners). The DFA Entities own stock in thousands

of companies and participate in thousands of securities transactions each year. A judicial order to a mutual fund or group trust requiring it to repay payments received years before could affect the stability of the clearance and settlement process if the order placed the fund or trust in a position where it could not meet its ongoing obligations in other securities transactions.

III.

The Decision of the District Court Should Be Reinstated

The court of appeals erred in holding that Section 546(e) does not bar Munford's claim against the DFA Entities. In the crux of its decision, the court of appeals incorrectly concluded that Section 546(e) only protects those types of entities specifically listed. The court of appeals' interpretation of Section 546(e) ignores the plain and unambiguous language of the statute and is inconsistent with Congress's purpose in enacting the statute.

A. The Court of Appeals' Decision Ignores the Plain Language of Section 546(e)

This Court consistently has held that a court should follow the statute's plain meaning unless a literal application of a statute would produce a result demonstrably at odds with the intention of the drafter. *See, e.g., United States v. Ron Pair Enter.*, 489 U.S. 235, 240-42 (1989). The court of appeals misinterpreted the plain and clear meaning of the statute. Section 546(e), by its terms, prohibits a debtor such as Munford from recovering settlement payments made either "by or to" a financial institution, securities clearing agency, or stock-

broker, except in cases involving actual fraud. The statute specifically provides that this exemption does not apply to settlement payments recoverable under Section 548(a)(i), i.e., settlement payments that were made within one year prior to the bankruptcy filing with the intent to hinder, delay, or defraud creditors.

In the present case, the undisputed facts demonstrate that payment to the DFA Entities was made by a financial institution, Citizens & Southern, to a clearing agency, DTC, and that DTC then transferred the payments to another financial institution, Morgan Guaranty. The merger payments were then transferred by Morgan Guaranty to the DFA Entities' accounts. Notwithstanding these facts, the court of appeals erroneously concluded that Section 546(e) did not apply because "[n]one of the entities listed in Section 546(e)—*i.e.*, . . . a stockbroker, financial institution, or securities clearing agency—made or received a transfer/payment." 98 F.3d at 610.

The effect of the Eleventh Circuit's decision is to amend the statute so that it only applies to settlement payments made by and to a listed entity. If Congress had wanted to so limit the statute, it easily could have done so by using "and" instead of "or". The fact that Congress used "or" should not be ignored, as the Eleventh Circuit did in its decision. *See Reiter v. Sonotone*, 442 U.S. 330, 338-40 (1979) (court should not ignore disjunctive "or" and rob disjunctive terms of their independent and ordinary significance).

Comparison with Sections 362(b)(6) and 548(d)(2) of the Bankruptcy Code further confirms that Section 546(e) exempts settlement payments made "by" the listed

entities without regard to the recipient. Section 362(b)(6) creates an exemption to the automatic stay to permit setoffs by the same entities that are enumerated in Section 546(e) of certain margin payments or settlement payments. 11 U.S.C. § 362(b)(6) (1994). By its terms, this section only inures to the benefit of the listed entities; it cannot be used by other types of entities—such as beneficial owners—to avoid the operation of the automatic stay. Section 548(d)(2)(B) provides that certain margin and settlement payments received by the same enumerated entities shall be deemed to be taken for value for purposes of the Code's fraudulent conveyance provisions. 11 U.S.C. § 548(d)(2)(B) (1994). Again, however, by its terms, this section would not apply to payments received by other types of entities. In contrast, Section 546(e) employs much broader language, explicitly exempting payments when made "by" as well as "to" stockbrokers, financial institutions, and clearing agencies. The choice of starkly different language in Section 546(e) reflects a deliberate choice by Congress that the court of appeals' decision abrogates. *Russello v. United States*, 464 U.S. 16, 23 (1983) ("where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

The court of appeals effectively added an additional requirement to the application of Section 546(e) by insisting that the financial institution that made the settlement payments acquire a beneficial interest in either the funds used to make the settlement payments or the shares sold in exchange for those funds. The statute itself contains no such requirements in its plain terms.

Since a financial institution was the transferor of the settlement payments, its transferee status under Section 550 is not relevant. Moreover, such a requirement would undermine the application of Section 546(e) because it is not uncommon that the various intermediaries in the settlement of a securities transaction (for example, stockbrokers, financial institutions, and clearing organizations) do not possess a beneficial interest in the funds or securities involved. *See Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990). By adding this additional requirement, the court of appeals has severely limited the application of the statute, contrary to its plain meaning.

Finally, the only other court of appeals to consider the application of Section 546(e) to settlement payments made to beneficial shareholders held that the plain language of the statute required that the statute apply. In *Kaiser Steel*, the Tenth Circuit found:

> On its face the statute is clear. The statute exempts payments made "*by or to*" a stockbroker, financial institution, or clearing agency. Again, unless there is some reason to believe the clear application is absurd or otherwise unreasonable, we can leave our inquiry at that.

952 F.2d at 1240. The Tenth Circuit examined the legislative history behind the statute, and concluded:

> Kaiser has given us no reason to replace the unambiguous language of the provision with clues garnered from the legislative history. Certainly, we cannot say that the clear application is absurd, given the fact that disruption in the securities industry—an inevitable result if lever-

> aged buy outs can freely be unwound years after they occurred—is also a harm the statute was designed to avoid.

952 F.2d at 1240-41 (citations omitted).

The court of appeals' construction of Section 546(e) is clearly at odds with the language of the statute. Review and reversal by this Court is necessary to ensure that the statute applies according to its terms as Congress intended.

B. The Court of Appeals' Interpretation of Section 546(e) Is Contrary to Congress's Intent

In light of the clear and unambiguous language in the statute, it is unnecessary and inappropriate to resort to the legislative history to glean Congress's intent. *See Union Bank v. Wolas*, 502 U.S. 151 (1991). However, an examination of the background of Section 546(e) further demonstrates the court of appeals' error. Not only does the court of appeals' decision ignore the clear and unambiguous language of Section 546(e), applying the statute according to its language is wholly consistent with Congressional intent and would further Congress's general purpose—recognized by the court below—to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions. Congress's purpose in enacting Section 546(e) (and its predecessor provision) was to provide certainty that settled securities transactions would not be reversed. The Eleventh Circuit's decision exacerbates the problem that Congress addressed when it protected the clearance and settlement system from the harm that would result if long-settled

transactions could be undone in a subsequent bankruptcy.

The predecessor provision to Section 546(e) was included in the Bankruptcy Reform Act of 1978 to correct problems caused by the decision in *Seligson v. New York Produce Exchange*, 394 F. Supp. 125 (S.D.N.Y. 1975). In *Seligson*, a bankruptcy trustee sought to recover $12 million in margin payments from a commodities clearing association on the grounds that the payments were fraudulent transfers made at a time the debtor was insolvent. The clearing association contended that it was not the transferee of the margin payments, but merely acted as a "conduit." The district court rejected this position.

William T. Bagley, Chairman of the Commodity Futures Trading Commission, testified during hearings on the Bankruptcy Reform Act that the *Seligson* decision, "if given a chance to evolve into established precedent, threaten[s] to destroy or drastically change the clearing house system." *Hearings Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary on H.R. 31 and H.R. 32 (Bankruptcy Act Revision)*, 94th Cong. 2405 (1976). Congress's response was to enact Section 764(c) as part of the Bankruptcy Reform Act, whereby Congress effectively overruled the *Seligson* decision. *See* S. Rep. No. 95-989 at 105 (1978).

In 1981, Congress further amended the Bankruptcy Code by enacting Section 546(e). Again, the Chairman of the CFTC stressed that additional amendments were necessary to eliminate any uncertainty that margin and settlement payments were transfers protected from recovery in bankruptcy. *See Hearings Before the Subcomm.*

on Monopolies and Commercial Law of the House Comm. on the Judiciary, 97th Cong. 4-5 (1981).

The court of appeals' decision, by focusing on the "conduit" status of Citizens & Southern, undermines Congress's purpose and resurrects the problem that Congress eliminated when it enacted Section 546(e). Indeed, because many securities transactions involve commodity brokers, forward contract merchants, stockbrokers, financial institutions, or securities clearing agencies that are acting as conduits, the decision by the court below largely nullifies the statute.

In Section 546(e), Congress balanced the rights of creditors against the need to protect settlement payments in appropriate circumstances. As the Securities and Exchange Commission has previously stated to this Court:

> While protecting settlement payments to shareholders will diminish the funds available for distribution to creditors, that consequence follows from Congress's balancing of the need to protect creditors against the need to protect settlement payments made by or to participants in the settlement system. By enacting Section 546(e), Congress determined that settlement payments made by or to stockbrokers, financial institutions, or clearing agencies should be shielded from the full reach of the creditor protections of the fraudulent conveyance laws, with recovery permitted only for transfers that involve actual fraud and occur within one year of a bankruptcy petition. If that scheme results in harm to creditors or others affected by an LBO, the remedy lies with Congress. See *Union Bank v. Wolas*, 112 S. Ct. at 533.

Brief for Securities and Exchange Commission in Opposition, at 13-14, *Kaiser Steel Resources, Inc. v. Pearl Brewing Co., cert. denied*, 505 U.S. 1213 (1992) (No. 91-1607).

The Eleventh Circuit's decision in this case disrupts the balance Congress sought to achieve in Section 546(e). This Court's correction of that decision is required.

CONCLUSION

The district court below and the Tenth Circuit in *Kaiser Steel* held (and Judge Hatchett agreed) that Section 546(e) bars actions to recover settlement payments made by financial institutions to beneficial shareholders. The Eleventh Circuit held to the contrary, narrowly construing the statute to not apply unless the settlement payment was made to one of the entities listed in the statute. For the reasons set forth above, a writ of certiorari should issue to review the judgment of the Court of Appeals for the Eleventh Circuit.

Respectfully submitted,

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App. 1

Matter of MUNFORD, INC., a/k/a
Majik Market, Debtor.

Danné Brokaw MUNFORD, as Executrix of the Estate of Dillard Munford; James M. Carroll; Russell Fellows; Joseph W. Hardin; Jay Rubel; Winston M. Blount; Herbert J. Dickson; James L. Ferguson; Robert M. Gardiner; Richard K. Leblond; Andrall E. Pearson; S.B. Rymer, Jr., Shearson Lehman Brothers, Inc.; DFA Investment Dimensions Group, Inc.; State Street Bank & Trust Company; PNC Bank, National Association; Boston Safe Deposit and Trust Company, Plaintiffs-Appellees,

v.

VALUATION RESEARCH CORPORATION,
Defendant,

Munford, Inc., Defendant-Appellant.

No. 94-9046.

United States Court of Appeals,
Eleventh Circuit.

Oct. 28, 1996.

Before HATCHETT, Chief Judge, CLARK, Senior Circuit Judge, and MILLS,* District Judge.

PER CURIAM:

As a matter of first impression in this circuit, we hold that 11 U.S.C. § 546(e) does not bar the trustee in bank-

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* Honorable Richard Mills, U.S. District Judge for the Central District of Illinois, sitting by designation.

ruptcy from avoiding payments the debtor corporation made to its shareholders in a leveraged buy-out.

FACTS

In August 1987, Dillard Munford, the founder and chief executive officer of Munford, Inc., suggested to Munford, Inc.'s board of directors (the board) that it sell Munford, Inc. At that time, Munford, Inc., a public company, operated three specialty retailer stores: Majik Market, a chain of convenience stores; World Bazaar, a chain of stores specializing in imported goods; and Lee Ward's Creative Crafts, an arts and crafts chain. Munford, Inc. also owned a majority interest in United Refrigerator Services, Inc. (URS). Based on Dillard Munford's suggestion, the board retained Shearson Lehman Brothers (Shearson) to evaluate Munford, Inc.'s financial viability and its fair market value. Following this evaluation, Shearson would make recommendations regarding how to best maximize shareholder value in the event the board decided to sell Munford, Inc.

In September 1987, Shearson presented a written report to the board identifying several selling options. Shearson, for example, opined that a sale of all of Munford's common stock would afford Munford, Inc. the most desirable means of maximizing shareholder value while preserving its financial viability. In contrast, Shearson disfavored a leverage buy-out (LBO) or a leverage recapitalization opining that Munford, Inc. would need all of its internally generated cash flow to fund growth. Consequently, Shearson believed that Munford, Inc. could not carry the heavy debt load associated with a leverage transaction. After reviewing Shearson's re-

port, the board authorized Shearson to prepare an offering memorandum and solicit potential purchasers for Munford, Inc. During this same period of time, Munford, Inc. executed severance contracts with senior officers Dillard Munford, Russell C. Fellows, and James M. Carroll agreeing to pay these officers severance pay in yearly installments upon the closing of the sale of Munford, Inc. In exchange, these officers promised to continue their employment with Munford, Inc. until it secured a purchaser. Despite Shearson's aggressive efforts to solicit potential purchasers of Munford, Inc., no one offered to purchase all of Munford, Inc.'s common stock. Faced with this reality, the board began considering LBO offers.

In January 1988, Deutschman & Co. offered to purchase Munford Inc.'s stock in an LBO. In February 1988, the board tentatively agreed to sell Munford, Inc. to Deutschman, but Deutschman withdrew its offer on March 3, 1988, after performing a due diligence examination. On May 2, 1988, Munford, Inc. sold its Lee Ward's stores to Prudential Bache because it had failed to secure a single purchaser for Lee Ward's stock. Later that month, the board received an offer from the Panfida Group to purchase its Majik and World Bazaar stores for $18.50 per share. On May 23 the board met with its lawyers and Shearson's representatives to consider the Panfida Group's offer. At that meeting, Munford Inc.'s lawyers advised the board that they had consulted with Citicorp and Citicorp confirmed its willingness to work with the Panfida Group. Shearson also advised the board that the Panfida Group had the backing of a company with assets in excess of $60 million. In addition, Shearson's representative stated that he was favorably impressed with the Panfida Group's ability to obtain financ-

ing. On June 1, 1988, Phillip Handy, the spokesperson for the Panfida Group, met with the board to discuss the proposal. During the meeting, Handy informed the board that the Panfida Group had purchased 291,177 shares of Munford, Inc. stock as evidence of its commitment to purchase Munford, Inc. Handy also noted that the Panfida Group intended to put additional capital into the company; however, he also advised the board that Panfida's equity participation would only be as much as Citibank required to finance the purchase.

On June 17, Munford, Inc. sold its stock in URS for $45.5 million and used the proceeds to pay company debt. Also during the month of June, the Panfida Group and Citicorp began a due diligence examination of Munford Inc.'s business records. After discovering potential environmental liability at some of the Majik stores, the Panfida Group decided to reduce its purchase price from $18.50 a share to $17 a share. The board approved the Panfida Group's new offering price and the proposed merger agreement. The proposed merger agreement required the Panfida Group to create Alabama Acquisition Corporation (AAC) and a subsidiary, Alabama Merger Corporation (AMC). The merger agreement also required the Panfida Group through AAC or AMC to deposit the funds necessary to purchase Munford Inc.'s outstanding stock with Citizens & Southern Trust Company, a financial institution within the securities clearance and settlement system.

Prior to finalizing the merger plan, AAC warranted to the board that the post-merger Munford, Inc. would remain solvent, would have a reasonable amount of working capital, and would have the ability to pay its debts as they came due. After receiving this assurance, Mun-

ford, Inc.'s lawyers prepared a detailed proxy statement for Munford, Inc.'s 3,100 shareholders outlining the merger agreement.[1] On October 18, 1988, the shareholders approved the merger plan. As provided in the merger agreement, each share of common stock was converted into the right to receive the merger price of $17 per share and extinguished the shareholders' ownership interest in Munford, Inc. The Panfida Group retired the 291,177 shares it purchased prior to the LBO merger without payment. The sale of Munford, Inc. to the Panfida Group closed on November 29, 1988. Thirteen months after the LBO transaction, on January 2, 1990, the post-Munford Corporation filed a Chapter 11 case in bankruptcy court.

PROCEDURAL HISTORY

On June 17, 1991, Munford, Inc. filed an adversary proceeding in bankruptcy court in the Northern District of Georgia on behalf of itself and unsecured creditors pursuant to 11 U.S.C. §§ 544(b) and 1107(a) (1988), seeking to recover LBO payments made to Munford, Inc.'s shareholders, severance payments made to Munford, Inc.'s officers and damages against directors, officers, and Shearson for breach of fiduciary obligations to Munford, Inc.

In Count I of Munford, Inc.'s complaint, it asserts fraudulent conveyance claims against two of Munford,

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[1] Munford, Inc.'s shareholders had no dissenter's rights of appraisal under O.C.G.A. § 14-2-250(d)(2) (1988), because Munford listed its shares on the New York Stock Exchange and because more than 2,000 shareholders held the stock.

Inc.'s largest former shareholders, the DFA Investment Dimensions Group, Inc. and Trustees of the DFA Group Trust. In Count I, Munford, Inc. also asserts fraudulent conveyance claims against former directors and officers who received payments for their Munford, Inc. shares in the LBO.[2] In Counts II and IV, Munford, Inc. asserts breach of fiduciary duty, negligence, mismanagement, and waste of corporate assets claims against the officers and directors. In Count III, Munford, Inc. asserts that the directors violated Georgia's share repurchase and distribution statutes in approving the LBO transaction. In Count V, Munford, Inc. asserts that the severance payments made to Dillard Munford, Fellows, and Carroll constituted fraudulent conveyances. In Count VI, Munford, Inc. claims that Shearson breached its fiduciary duty. Finally, in Count IX Munford, Inc. claims that Shearson aided and abetted the directors and officers' alleged breaches of fiduciary duty.

The shareholders, directors, officers, and Shearson (collectively appellees) filed motions for summary judgment contending that each of Munford, Inc.'s claims failed as a matter of law. On April 5, 1994, the bankruptcy court filed its proposed findings of fact and conclusions of law recommending that the district court grant Shearson's motion for summary judgment. In a separate proposed

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[2] Count I specifically asserts claims against Dillard Munford, chief executive officer; Russell C. Fellows, president and chief operating officer; James M. Carroll, vice president and secretary; Joseph W. Harden, vice president and treasurer; and J.E. Rubel. Count I also asserts claims against directors Dillard Munford, Fellows, Robert M. Gardiner, Richard K. LeBlond, II, Herbert J. Dickson, Winston M. Blount, S.B. Rymer, Jr., Andrall E. Pearson, and James L. Ferguson.

findings of fact and conclusion of law, the bankruptcy court recommended that the district court deny the shareholders, officers, and directors' motions for summary judgment. The district court adopted the bankruptcy court's recommendation in part granting summary judgment in favor of Shearson. The district court also adopted the bankruptcy court's recommendation with respect to Count III and denied the directors' motion for summary judgment on the distribution statute claim. The district court, however, rejected the bankruptcy court's recommendation as to Munford, Inc.'s claims against the shareholders, directors, and officers with respect to Counts I, II, and IV, and granted summary judgment on those counts on August 4, 1994.

On August 26, 1994, the district court amended its order, pursuant to Federal Rules of Civil Procedure 54(b), and entered final judgment to allow this appeal to proceed. Munford, Inc. now appeals the district court's grant of summary judgment in favor of the shareholders, officers, and directors on Counts I, II, and IV. Munford, Inc. also appeals the district court's granting of summary judgment in favor of Shearson on Count IX and has abandoned its claims under Count VI.[3]

CONTENTIONS

Munford, Inc. raises four contentions. First, Munford, Inc., contends that the district court erred in concluding that the LBO payment shareholders received for their

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[3] The directors also appeal the district court's denial of their motion for summary judgment on Munford, Inc.'s share repurchase and distribution claim (Count III) in Case No. 94-9216.

shares constituted a settlement payment within the meaning of 11 U.S.C. § 546(e). Second, Munford, Inc., contends that the district court erred in concluding that its breach of fiduciary duties, negligence, mismanagement, and waste of corporate asset claims against the directors and officers failed as a matter of law. Specifically, Munford, Inc. argues that sufficient evidence supports its claim that the directors and officers failed to fulfill their fiduciary obligations to evaluate the proposed LBO merger agreement. Third, Munford, Inc. contends that the severance payments made to its officers lacked consideration; therefore, the district court erred when it concluded that the payments did not constitute a fraudulent conveyance under Georgia law. And finally, Munford, Inc. contends that the district court erred in granting summary judgment in favor of Shearson on its aiding and abetting breach of fiduciary duty claim because Georgia courts would recognize this claim.

Appellees contend that the district court properly granted summary judgment in their favor on each of the claims.

ISSUES

We address the following issues: (1) whether the LBO payments received in exchange for shares constituted a settlement payment within the meaning of section 546(e); (2) whether the district court erred in granting summary judgment in favor of the officers and directors on Munford, Inc.'s claims of breach of fiduciary duty, negligence, mismanagement, and waste of corporate assets; (3) whether Munford, Inc.'s severance payments to its officers constituted fraudulent conveyances under

Georgia law; and (4) whether the district court erred in granting summary judgment in favor of Shearson on Munford, Inc.'s aiding and abetting claims.

DISCUSSION

A. LBO Payments

We review the grant of summary judgment *de novo*. *Orlando Helicopter Airways v. United States*, 75 F.3d 622, 624 (11th Cir.1996). Summary judgment is appropriate where no genuine issues of material fact exist and the moving party is entitled to judgment as a matter of law. *Canadyne-Georgia Corp. v. Continental Ins. Co.*, 999 F.2d 1547, 1554 (11th Cir.1993).

Pursuant to 11 U.S.C. § 544(b), a trustee in bankruptcy or the debtor acting as trustee may avoid any transfer of property of the debtor that is voidable under the applicable state law unless otherwise stated in the Bankruptcy Code. 11 U.S.C. § 544(b). Section 544(b) is commonly referred to as the "strong arm" clause. One exception to the trustee's avoidance power exists under section 546(e). Section 546(e) states in pertinent part:

> Notwithstanding section 544 . . . of this title, the trustee may not avoid a transfer that is . . . [a] settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

11 U.S.C. § 546(e) (1988). Congress enacted section 546(e) "to minimize the displacement caused in the commodities and securities market in the event of a

major bankruptcy affecting those industries." H.R.Rep. No. 97-420, 97th Cong., 2d Sess. 1 (1982), U.S.Code Cong. & Admin.News 583. With the passage of section 546(e), "Congress [also] sought to 'promote customer confidence in commodity markets generally' via 'the protection of commodity market stability.'" *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (quoting Sen. R. No. 989, 95th Cong., 2d Sess. 8 (1978)).

In this case, the district court entered summary judgment in favor of the shareholders on Munford, Inc.'s fraudulent conveyance claim finding that the LBO payments Munford, Inc. made to the shareholders constituted settlement payments within the meaning of section 741(8). *See* 11 U.S.C. § 741(8). Consequently, the district court held that 11 U.S.C. § 546(e) did not authorize a bankruptcy trustee or a debtor in possession acting as trustee to avoid such transfers under state law because the shareholders received their settlement payments from Citizens & Southern Trust Company, a financial institution. On appeal, Munford, Inc. contends that the district court erred in concluding that the LBO payments the shareholders received for their shares constituted settlement payments for purposes of section 546(e).

Section 741(8) defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or *any other similar payment commonly used in securities trade*." 11 U.S.C. § 741(8) (1988) (emphasis added). Munford, Inc. does not argue that LBO payments are uncommon. Rather, it urges this court to define settlement payments in the context of LBOs narrowly, asserting that

LBO mergers are essentially private transactions between the merging companies and their existing shareholders and therefore do not sufficiently involve the securities settlement and clearance system. Munford, Inc. notes that this LBO merger did not use the clearance and settlement system to match buyers with sellers of securities, account for the transaction, or guarantee the transaction. Munford, Inc. asserts that the settlement and clearance system was simply used to convey the LBO payments to the tendering shareholders. Munford, Inc. further argues that characterizing the LBO payments as settlement payments does not advance the goal of protecting the clearance and settlement system because LBO transactions do not utilize the entire clearance and settlement system.[4] Finally, Munford asserts that construing the LBO payments as settlement payments wholly frustrates the remedial goal of fraudulent conveyance law and the fair treatment of unsecured creditors. The shareholders, on the other hand, contend that construing section 546(e) to apply to the LBO payments promotes investor confidence in the securities market. To hold otherwise, the shareholders argue, would undermine all mergers or acquisitions of public companies.

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[4] In support of its position, Munford, Inc. cites *Wieboldt Stores, Inc. v. Schottenstein*, 131 B.R. 655 (N.D.Ill.1991). In *Wieboldt*, the district court held that LBO payments do not constitute a settlement payment within the meaning of the Code, reasoning that permitting avoidance of LBO payments posed no significant threat to the clearance and settlement system in the securities industry. *Wieboldt*, 131 B.R. at 664-65. We reject the reasoning of *Wieboldt* finding that even granting trustees avoidance powers under limited circumstances in the LBO context has the potential to lessen confidence in the commodity market as a whole.

The court concludes that whether the LBO payments qualify as section 546(e) settlement payments is not dispositive of the dispute—in fact, the court will presume that the LBO payments were settlement payments. Although the payments were presumptively settlement payments, section 546(e) is not applicable *unless* the transfer (or settlement payment) was "made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." 11 U.S.C. § 546(e). Here, the transfers/payments were made *by* Munford *to* shareholders. None of the entities listed in section 546(e)—*i.e.*, a commodity broker, forward contract merchant, stockbroker, financial institution, or a securities clearing agency—made or received a transfer/payment. Thus, section 546(e) is not applicable.

True, a section 546(e) financial institution was presumptively involved in this transaction. But the bank here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. The bank never acquired a beneficial interest in either the funds or the shares.

Importantly, a trustee may only avoid a transfer to a "transferee." *See* 11 U.S.C. § 550. Since the bank never acquired a beneficial interest in the funds, it was not a "transferee" in the LBO transaction. *See In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200 (11th Cir.1988) ("When banks receive money for the sole purpose of depositing it into a customer's account . . . the bank never has actual control of the funds and is not a § 550 transferee."). Rather, the shareholders were the only "transferees" of the funds here. And, of course, section 546(e) offers no protection from the trustees avoiding powers to

shareholders; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies. Accordingly, regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities.[5] We conclude that the district court erred with respect to this issue and reverse.

B. Breach of Fiduciary Duty and Related Claims

We next address Munford, Inc.'s contention that the district court erred in granting summary judgment in favor of the officers and directors on Munford, Inc.'s claims of breach of fiduciary duty, negligence, mismanagement, and waste of corporate assets.

Section 14-2-152.1(a)(1) of the Georgia Code requires directors and officers of companies to discharge their duties in good faith and with the care of an ordinary prudent person. Munford, Inc. contends that the district court erred in concluding that no disputed material facts existed as to whether the directors and officers discharged their duties in good faith and with the care of an ordinary prudent person. Specifically, Munford, Inc., argues that substantial evidence supports its contention that the directors and officers approved the LBO without considering the economic effect of the transaction upon the corporation in violation of section 14-2-152.1(a)(1). In

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[5] For a discussion of this issue, *see In re Healthco Int'l Inc. v. Hicks, Muse & Co., Inc.*, 195 B.R. 971, 981-83 (Bankr.D. Mass.1996).

support of this argument, Munford, Inc. makes two assertions. First, Munford, Inc. asserts that the officers and directors disregarded Shearson's September 1987 written report disfavoring LBO transactions.[6] Second, Munford, Inc. asserts that officers and directors disregarded Deutschman's reasons for refusing to proceed with its planned purchase of Munford, Inc.

In addition, Munford, Inc. argues that Article 9 of its Articles of Incorporation creates a private right of action on behalf of creditors independent of section 14-2-152.1(a)(1). Munford, Inc. notes that Article 9 requires the directors and officers to give due consideration to "'the extent to which the assets of the corporation will be used' for financing and 'the social, legal, and economic effects of the transaction on the employees, customers, and other constituents of the corporation.'" Based on this language, Munford, Inc. asserts that directors and officers have a higher duty of care than imposed under state law.

The directors and officers contend that they discharged their duties in good faith and with the care of an ordinary prudent person. The directors and officers also argue that they made an informed judgment when they decided to accept Panfida's LBO proposal. They stress that they hired Shearson to perform a financial assessment of Munford, Inc., consulted attorneys regarding their duties to the company, including their duties under the Articles of Incorporation throughout their decision-

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[6] In that report, Shearson opined that Munford, Inc. needed all of its internally generated cash flow to fund growth and could not be able to finance increased leverage resulting from financial restructuring.

making process, and that at all times during their service to Munford, Inc., the company was solvent. They therefore argue that in deciding whether to sell Munford, Inc. they had an unqualified duty to maximize shareholder value. With respect to Munford, Inc.'s post-LBO financial stability, the directors and officers argue that Citicorp's decision to finance the LBO merger and AAC's warranty—that post-LBO Munford, Inc. would remain solvent, have a reasonable amount of working capital, and have ability to pay its debt—led them to believe that Munford, Inc. could carry the heavy load associated with a leveraged transaction. Finally, the directors and officers contend that Article 9 did not establish a fiduciary duty greater than under state law or create a private right of action on behalf of creditors. Although Article 9 provides that directors give due consideration to social, legal, and economic effects of a transaction on employees, customers, and other constituents of the corporation, the directors and officers argue that this provision does not identify creditors as persons to whom due consideration is owed. The directors and officers therefore argue that a constituency's interest is only relevant when the consideration of the constituency also benefits the shareholders.

In determining whether directors and officers have satisfied their statutory duty, Georgia courts apply the business judgment rule. *See Millsap v. American Family Corp.*, 208 Ga.App. 230, 430 S.E.2d 385, 388 (1993). The business judgment rule protects directors and officers from liability when they make good faith business decisions in an informed and deliberate manner. *Cottle v. Storer Communication, Inc.*, 849 F.2d 570, 575 (11th Cir. 1988). In this case, the record is replete with evidence

that the directors and officers consulted legal and financial experts throughout the solicitation and negotiation for a purchaser for Munford, Inc. Applying the business judgment rule, we conclude that the directors and officers satisfied their duties under section 14-2-152.1(a)(1). Because Munford, Inc. has failed to present any binding legal authority to support its contention that Article 9 creates a cause of action independent of Georgia law, we reject this argument. Accordingly, we affirm the district court's grant of summary judgment on this issue.

C. Severance Contracts

The district court also granted summary judgment in favor of the officers and directors on Munford, Inc.'s fraudulent conveyance claims. In its complaint, Munford, Inc. alleged that the severance payments it made to Dillard Munford, Fellows and Carroll lacked consideration, and therefore constituted fraudulent conveyances under Georgia law.[7] In order for Munford, Inc. to establish a fraudulent conveyance claim under Georgia law, it must show: (1) a conveyance of property; (2) valuable consideration; and (3) that it was insolvent at the time

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[7] Section 18-2-22 of the Georgia Code provides:

> The following acts by debtors shall be fraudulent in law against creditors and others and as to them shall be null and void . . . every voluntary deed or conveyance *not for a valuable consideration* made by a debtor who is insolvent at the time of the conveyance.

Brown v. Citizens & Southern National Bank, 253 Ga. 119, 317 S.E.2d 180, 183 (1984) (quoting O.C.G.A. § 18-2-22(3)) (emphasis added).

of the conveyance or that the conveyance rendered it insolvent. *Brown*, 317 S.E.2d at 183.

The district court entered summary judgment finding that valuable consideration in the form of the officers' promises to continue employment through the closing of the sale of Munford, Inc. supported the severance payments. Munford, Inc. contends that the district court erred in concluding that Munford, Inc. received valuable consideration in exchange for the severance contracts. Munford, Inc. argues that Dillard Munford's testimony refutes the finding that Dillard Munford's promise constituted valuable consideration because he stated in his deposition testimony that he would have remained with the company through closing in spite of his severance contract. Based on this admission, Munford, Inc. asserts that all of the severance payments constituted gifts rewarding these officers for past services for which they had already been paid.

Dillard Munford, Fellows, and Carroll respond to Munford, Inc.'s arguments asserting that their existing severance contracts each arose due to preexisting severance contracts executed in 1979 or earlier. They also argue that their continued services to the company—beginning with Munford, Inc.'s search in 1987 for a single purchaser for its outstanding stock and ending in 1988 when Munford, Inc. closed the LBO transaction with the Panfida Group—provided sufficient consideration for the severance payments. Specifically, they argue that they provided general corporate management services, advice, strategy, and guidance to Munford, Inc. during the relevant period.

We conclude that Munford, Inc.'s argument lacks merit. Georgia courts hold that "valuable consideration is founded on money or something convertible into money, or having value in money." *Stokes v. McRae*, 247 Ga. 658, 278 S.E.2d 393, 394 (1981). Georgia case law also clearly states that, "[c]ontinued performance under a terminable at-will contract furnishes sufficient consideration for the promise of additional severance pay." *Royal Crown Companies, Inc. v. McMahon*, 183 Ga.App. 543, 359 S.E.2d 379, 381 (1987). We note that this rule of law leads to a just result in this case. If Munford, Inc. had not entered into the severance payment contract and these officers left Munford, Inc. prior to the closing of the LBO, Munford, Inc.'s efforts to sell its stock to a single purchaser probably would have been frustrated. Also, Munford, Inc. would have been without recourse against these officers because Munford, Inc. employed these officers as employees at-will. The severance contracts giving rise to the severance payments, however, provided Munford, Inc. with the assurance that the officers would not leave without providing Munford, Inc. recourse in the event their leaving frustrated its plans to sell its stock to a single purchaser. We therefore find that this assurance constituted valuable consideration. Accordingly, we affirm the district court's grant of summary judgment on this claim.

D. The "Aiding and Abetting" Claim

The last issue we address is whether the district court erred in concluding that Munford, Inc.'s claim of aiding and abetting a breach of fiduciary duty against Shearson failed as a matter of law. Munford, Inc. urges this court

to recognize a cause of action for aiding and abetting a breach of fiduciary duty under Georgia state law, arguing that Georgia courts would recognize the tort of aiding and abetting a breach of fiduciary duty. Such an action, Munford, Inc. contends, would require a showing of (1) a fiduciary duty on the part of the primary wrongdoer, (2) a breach of fiduciary duty, (3) the knowledge of the breach by the alleged aider and abettor, and (4) the aider and abettor's substantial assistance or encouragement of the wrongdoing. Munford, Inc. argues that it has satisfied this showing. Specifically, Munford, Inc. alleges that Shearson aided and abetted the directors' and officers' breach of fiduciary duty when it provided a fairness opinion concerning the Panfida Group's offering price enabling the LBO transaction to go forward. It also asserts that Shearson, based upon its 1987 report, knew that LBO was not financially prudent for Munford, Inc. and knew that Munford, Inc.'s financial condition continued to deteriorate. In support of its argument that this court should recognize an aiding and abetting action, Munford, Inc. notes that Georgia courts have acknowledged an aiding and abetting cause of action in torts involving violence, the sale of unregistered securities, breaches of covenants with employment contracts, and fraudulent conveyances. In response, Shearson argues that the district court correctly held that the "imposition of aider and abettor liability for breaches of fiduciary duty essentially extends fiduciary obligations beyond the scope of the confidential or special relationship" on which the directors' and officers' obligations are based.

In the absence of state law, we are "obliged to resolve the issue of law as the Georgia state court would." *Imperial Enterprises, Inc. v. Fireman's Fund Ins. Co.*,

535 F.2d 287, 290 (5th Cir.1976). In this case, we decline to extend aider and abettor liability to breaches of fiduciary duty concluding that Georgia courts would not recognize such a cause of action. To hold otherwise, as the district court found, would enlarge the fiduciary obligations beyond the scope of a confidential or special relationship. It is important to note that in this case Munford, Inc. does not claim that Shearson failed to fully advise Munford, Inc. of the potential risk of the LBO. The board, after considering the risk Shearson identified, decided to proceed with the LBO despite Shearson's initial caution to them. Moreover, the board directed Shearson to conduct a fairness report with respect to Panfida's offer. Shearson issued this report as directed. Munford, Inc. now seeks to hold Shearson liable for performing its task competently and with full disclosure. Even assuming that Georgia courts will someday recognize a cause of action for aider and abettor liability in the context of a breach of fiduciary duty claim, the facts in this case do not warrant its creation now.

CONCLUSION

For the foregoing reasons, we reverse the district court's grant of summary judgment in favor of the shareholders on Munford, Inc.'s fraudulent conveyance claim. We affirm summary judgment on the remaining claims.

AFFIRMED in part; REVERSED in part; and REMANDED for further proceedings.

HATCHETT, Chief Judge, concurring in part and dissenting in part.

I agree with the majority opinion insofar as it concludes that the district court did not err in granting the directors, officers and Shearson summary judgment. I do not agree, however, with the majority's holding that the district court erred in granting the shareholders summary judgment.

Section 546(e) precludes the trustee in bankruptcy from avoiding settlement payments made by or to a financial institution, commodity broker, forward contract merchant, stockbroker, or securities clearing agency unless the debtor company made such payments with the "actual intent to hinder, delay or defraud" creditors. 11 U.S.C. § 548(a)(1); *see also* 11 U.S.C. § 546(e). In this case, Munford, Inc. deposited funds to purchase its outstanding stock with Citizens & Southern Trust Company, a financial institution. Citizens & Southern Trust Company then made settlement payments to the shareholders for their stock. Munford, Inc., acting as trustee, filed this action seeking to avoid the payments Citizens & Southern Trust Company made to the shareholders. The district court granted summary judgment in favor of the shareholders concluding that section 546(e) barred the avoidance of settlement payments "made by" a financial institution.

In reversing the grant of summary judgment, the majority holds that whether the LBO payments qualify as settlement payments under section 546(e) is not dispositive on the issue of whether a trustee in bankruptcy can avoid such transfers under state law. Instead, the majority concludes that the dispositive issue is whether

the financial institution acquired a beneficial interest in the settlement payments. I believe the majority, rather than require Munford, Inc. to prove "actual intent to hinder, delay or defraud" its creditors, chose to disregard the plain language of section 546(e) in order to create a new exception to its application. Because I believe that LBO payments made to shareholders constitute settlement payments for purposes of section 546(e) and that section 546(e) only permits a trustee in bankruptcy to avoid settlement payments made to shareholders by a financial institution when such payments are made with the actual intent to hinder, delay or defraud creditors, I respectfully dissent.

[Filed August 10, 1994]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

MUNFORD, INC. Plaintiff v. DILLARD MUNFORD; RUSSELL G. FELLOWS; WINTON M. BLOUNT; HERBERT J. DICKSON; JAMES L. FERGUSON; ROBERT M. GARDINER; RICHARD K. LEBLOND; ANDRALL E. PEARSON; S. B. RYMER, JR.; JAMES M. CARROLL; JOSEPH W. HARDIN; JAY E. RUBEL; STATE STREET BANK & TRUST COMPANY; PROVIDENT NATIONAL BANK; DFA INVESTMENT DIMENSIONS GROUP, INC.; SHEARSON LEHMAN BROTHERS, INC. Defendants.	)	CASE NO. 1:94-cv-348-GET ADVERSARY PROCEEDING 91-6417

ORDER

The above-styled matter is presently before the court for de novo review pursuant to Rule 9033, 11 U.S.C., of proposed findings of fact and conclusions of law of the bankruptcy court [bankr. docket no. 611] recommending that the summary judgment motions of the following defendants be denied: Dillard Munford [bankr. docket no. 505]; Fellows and Carroll [bankr. docket no. 508]; Hardin and Rubel [bankr. docket no. 510]; Gardiner, LeBlond, Dickson, Blount, Rymer, Pearson, Ferguson [bankr. docket no. 482]; DFA Investment Dimensions Group, Inc., State Street Bank & Trust Co., and Provident National Bank [bankr. docket no. 422]. The parties filed

objections to the bankruptcy court's findings of fact and conclusions of law as follows: objections of Dillard Munford [docket no. 20]; objections of DFA entities [docket nos. 17, 18, 19]; objections of Munford Inc. [bankr. docket no. 626]; objections of Gardiner, LeBlond, Dickson, Blount, Rymer, Pearson, Ferguson [bankr. docket no. 627]; objections of Fellows, Carroll, Hardin, Rubel [bankr. docket no. 629].

Introduction

This adversary proceeding arises out of the bankruptcy of plaintiff Munford, Inc. (plaintiff or Munford), In Re: Munford, Inc., A90-78-SWC. Munford seeks to recover against its former officers (Dillard Munford, Chief Executive Officer; Fellows, President and Chief Operating Officer; Carroll, Vice-President and Secretary; Hardin, Vice-President and Treasurer; and Rubel, Vice-President and Administrative officer) and directors (Dillard Munford, Fellows, Gardiner, LeBlond, Dickson, Blount, Rymer, Pearson, and Ferguson) for their alleged role in approving and carrying out the purchase of Munford by an investment group organized by Philip Handy, a non-party. Dillard Munford and Fellows were both officers and directors. Munford also seeks to avoid payments made pursuant to the purchase of Munford to former Munford shareholders DFA Investment Dimensions Group, Inc., DFA Group Trust, and DFA Participating Group Trust (collectively referred to herein as the DFA entities). Provident National Bank is a defendant as trustee of the DFA Group Trust; State Street Bank & Trust Co. is a defendant as trustee of the DFA Participating Group Trust. Lastly, the plaintiff attempts to void

severance payments made by Munford to former officers Dillard Munford, Fellows and Carroll. The above defendants have filed motions for summary judgment in this adversary proceeding upon which the bankruptcy court has issued proposed findings of fact and conclusions of law. The bankruptcy court recommends that the defendants' summary judgment motions be denied.

Standard of Review

The bankruptcy court issued its findings of fact and conclusions of law in this matter pursuant to 28 U.S.C. § 157(c)(1). Although one or more parties to this litigation filed appeals to this court of the bankruptcy court's findings of fact and conclusions of law, the parties are now in agreement and have represented to the court that this matter is appropriately before the court for review under Bankr. Rule 9033, 11 U.S.C. Under that rule, the "district court shall make a de novo review upon the record or, after additional evidence, of any portion of the bankruptcy judge's findings of fact or conclusions of law to which specific written objection has been made." Rule 9033(d), 11 U.S.C. Accordingly, this court's review of the bankruptcy court's opinion is de novo.

Background

Pursuant to the above standard of review and the standard for evaluating summary judgment motions set forth below, the court finds the following facts for the purposes of this order only.

Prior to November 29, 1988, plaintiff Munford was a publicly held Georgia corporation operating three pri-

mary businesses: (1) Majik Market convenience stores, (2) World Bazaar retail stores, and (3) LeeWards Creative Crafts retail stores. Munford also held an interest in United Refrigerated Services, Inc. Munford's principal business was its chain of Majik Market convenience stores.

Prior to November 29, 1988, the following individuals and entities were holders of Munford stock: officers Dillard Munford, Fellows, Carroll, Hardin and Rubel; outside directors Gardiner, LeBlond, Dickson and Rymer; and the DFA entities. The DFA entities, which are mutual funds and unit trusts, were beneficial shareholders of 234,158 shares of Munford stock as of November 29, 1988.

In August of 1987, Munford's directors retained Shearson Lehman Brothers, Inc. to evaluate the company's future. After conducting a financial review and analysis of Munford, Shearson recommended that a sale of 100% of Munford's commons stock would maximize shareholder value. Also based on its analysis, Shearson further concluded that a leveraged buy-out or leveraged recapitalization would not successfully maximize shareholder value. After reviewing Shearson's report, Munford's directors authorized Shearson to prepare an offering memorandum and to solicit potential purchasers of Munford. Shearson's efforts to find a purchaser for Munford were not successful.

Thereafter, in early 1988, Philip Handy organized a group of investors (hereafter collectively referred to as "the purchasers" or the "new investors") to make a bid to purchase Munford through a leveraged buy-out (LBO). Munford's directors first considered the new investors'

proposal at the directors meeting on May 23, 1988. At this meeting, Munford's counsel advised the directors of the proposal and of various factors to be considered when evaluating the new investors' offer. The directors unanimously approved of the proposed purchase of all of Munford's outstanding shares at a price of $18.50 per share and began pursuing a definitive agreement.

At the June 1, 1988 meeting of Munford's directors, Handy presented his plan for financing the LBO. Handy indicated that the purchase would be highly leveraged with as little equity participation by the new investors as possible. To accomplish the LBO, the new investors formed Alabama Acquisition Corporation (AAC) and Alabama Merger Corporation (AMC). AMC was a wholly owned subsidiary of AAC. Under the plan, AMC would merge with Munford, leaving Munford as the surviving entity.

On August 9, 1988, Munford's directors formally approved the amended merger agreement which reduced the sale price of Munford stock to $17.00 per share. At this meeting, Shearson presented a fairness opinion indicating that such a price was fair to Munford's shareholders. The merger agreement called for AAC and AMC to deposit or cause to be deposited into a trust account with an exchange agent sufficient cash to purchase Munford's outstanding shares of common stock for $17.00 per share. The agreement called for the exchange agent, Citizens & Southern Trust Co. (C & S Trust), to be given irrevocable authority to make cash payments to shareholders as called for in the agreement.

On November 29, 1988, the LBO was consummated. AAC contributed $550,000 and 291,177 shares of Mun-

ford stock to AMC; AMC and Munford then merged, with Munford remaining as the surviving entity. Citicorp Bank (Citicorp) issued a $54,800,000 line of credit to Munford; the line of credit was secured by a first priority lien on virtually all of Munford's assets. On November 29, 1988, Handy, acting as chairman of Munford, drew approximately $53,244,000 from Munford's Citicorp line of credit and these funds were used by Munford to complete the LBO. Munford's other liquid assets at the time of the LBO included approximately $16,900,000 in cash and certificates of deposit, $21,750,000 from the sale of Munford's World Bazaar units, and the $550,000 cash received from the merger with AMC. Thus, Munford's total liquid assets at the time of the LBO equaled approximately $92,500,000. (See depo. exhibit 378.)

The outflow of funds from Munford pursuant to the LBO occurred as follows. Munford transferred $61,811,235 from its Citizens & Southern National Bank account #00168005 to C & S Trust, the exchange agent for the share repurchases. These funds were paid by C & S Trust to Munford's shareholders tendering their shares in exchange for $17 per share. All of Munford's 3,927,240 outstanding shares were tendered except for the 291,177 shares held by AMC and another 108 shares (3,927,240 outstanding shares less 291,285 shares not redeemed = 3,635,955 shares redeemed at $17/share = $61,811,235). The 291,177 shares held by AMC were retired by Munford without consideration. (See depo. exhibit 378.)

The LBO also called for Munford to expend over $25,000,000 to pay off its pre-LBO creditors. This was done to allow Citicorp to have a first priority lien on all Munford assets as security for the line of credit. The

remainder of funds paid-out by Munford went to pay various LBO fees and related payments. In one instance, Munford paid a "fee" of $550,000 to Winter Park Capital, an affiliate of AAC. Munford also paid approximately $3,100,000 in other LBO fees and expenses. The total out-flow of funds from Munford pursuant to the LBO totaled approximately $90,600,000.

Munford filed for bankruptcy protection on January 2, 1990. Munford, as debtor in possession acting with the power of a trustee under 11 U.S.C. § 1107(a), filed its complaint for the benefit of Munford's estate and its unsecured creditors on June 17, 1991; Munford's amended and restated complaint was filed on July 23, 1992. Munford's complaint states five counts against the instant defendants. In Count I, Munford asserts that the payments to Munford shareholders pursuant to the LBO constituted fraudulent conveyances under O.C.G.A. § 18-2-22(3); defendants in Count I are all of the named defendants who were Munford shareholders: Dillard Munford, Fellows, Dickson, Gardiner, LeBlond, Rymer, Carroll, Hardin, Rubel, and the DFA entities (the shareholder defendants). In Counts II and IV, Munford asserts that its former directors and Carroll breached their fiduciary duty to Munford and negligently mismanaged and wasted corporate assets. In Count III, Munford asserts that the director defendants violated Georgia's corporate distribution laws under O.C.G.A. § 14-2-91 & § 14-2-92 (1988) repealed by Ga. L 1988, p. 1070, § 1, effective July 1, 1989. In Count V, Munford seeks to have severance payments paid to defendants Dillard Munford, Fellows, and Carroll set aside as fraudulent conveyances under O.C.G.A. § 18-2-22(3).

The defendants filed motions for summary judgment. By opinion dated April 4, 1994 [bankr. docket no. 611], the bankruptcy court recommended that the defendants' motions for summary judgment be denied as to all five counts and all defendants. The defendants filed objections to the bankruptcy judge's recommendation as to all five counts. The plaintiff filed an objection as to the bankruptcy court's interpretation of the legal standard to apply in considering whether valuable consideration was given under Georgia's fraudulent conveyance statute.

This court heard oral arguments on July 26, 1994. The court will consider the parties' objections as they pertain to each of the five counts pertaining to the instant defendants.

Discussion

I. Summary Judgment Standard.

Bankruptcy Rule 7056 provides that "Rule 56 F.R.C.P. applies in adversary proceedings." Rule 7056, 11 U.S.C. Rule 56(c), Fed. R. Civ. P., defines the standard for summary judgment: courts should grant summary judgment when "there is no genuine issue as to any material fact . . . and the moving party is entitled to judgment as a matter of law." In Celotex Corp. v. Catrett, 477 U.S. 317, 324, 106 S. Ct. 2548, 2553 (1986), the Supreme Court interpreted Rule 56(c) to require the moving party to "always bear the initial responsibility of informing the district court of the basis of its motion, and identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any' which it believes demonstrate the absence of a genuine issue of material fact." Thus, the

movant's burden is "discharged by 'showing'—that is, pointing out to the district court—that there is an absence of evidence to support the nonmoving party's case." Id. 477 U.S. at 325, 106 S. Ct. at 2554; see also United States v. Four Parcels of Real Property, 941 F.2d 1428, 1437 (11th Cir. 1991).

Once the movant has set this burden, the burden on summary judgment shifts to the nonmoving party who must establish that there is a genuine material issue of fact remaining for trial. Celotex, 477 U.S. at 325, 106 S. Ct. at 2554. The nonmoving party must go beyond the pleadings and submit evidence in the form of affidavits, depositions, admissions and the like, to demonstrate that a genuine issue of material fact does exist. Id. The Supreme Court stated in Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 257, 106 S. Ct. 2505, 2514 (1986), "that the plaintiff, to survive the defendant's motion, need only present evidence from which a jury might return a verdict in his favor. If he does so, there is a genuine issue of fact that requires a trial." In making a determination of whether there is a material issue of fact, "[t]he evidence of the non-movant is to be believed, and all justifiable inferences are to be drawn in his favor." Id. 477 U.S. at 255, 106 S. Ct. at 2513; Rollins v. TechSouth, Inc., 833 F.2d 1525, 1529 (11th Cir. 1987).

However, an issue is not genuine if it is unsupported by evidence or if it is created by evidence that is "merely colorable" or is "not significantly probative." Anderson, 477 U.S. at 249-50, 106 S. Ct. at 2511. Similarly, a fact is not material unless it is identified by the controlled substantive law as an essential element of the nonmoving party's case. Id. at 248. Thus, to create a genuine issue of material fact for trial, the party opposing the

summary judgment must come forward with specific evidence of every element essential to his case with respect to which (1) he has the burden of proof and (2) the summary judgment movant has made a plausible showing of the absence of evidence on the necessary element. Celotex, 477 U.S. at 323, 106 S. Ct. at 2552.

II. Application of Standard.

A. Count I. The crucial aspect of the LBO transaction was Munford's repurchase of its outstanding shares from its shareholders for $17.00 per share.

In Count I, Munford seeks to avoid under 11 U.S.C. § 544(b) the share repurchase payments paid to the shareholder defendants pursuant to the LBO transaction (approximately $10,800,000). (See plaintiff's first amended complaint [bankr. docket no. 192] at ¶¶ 2 & 7.) As a debtor in possession, Munford is entitled to utilize the "strong arm" provision of 11 U.S.C. § 544(b) to avoid conveyances which are avoidable under state law. In relevant part, § 544(b) provides that a debtor in possession "may avoid any transfer of an interest of the debtor in property . . . that is voidable under applicable law by a creditor holding an unsecured claim." Thus, Munford can avoid, for the benefit of its estate, all transfers to the shareholder defendants as long as Munford can establish at least one actual, unpaid claim held by an unsecured creditor prior to the time of the LBO payments to the shareholders. See Moore v. Bay, 284 U.S. 4, 5 (1931); In Re Dante, 1 Bankr. 547, 548 (Bankr. N.D. Ga. 1979); 4 Collier on Bankruptcy, ¶ 544.03 (15th ed. 1989). It is undisputed that at least one such claim existed. In short, therefore, "[s]ection 544(b) of the Bankruptcy Code, the

so-called 'strong arm' clause, grants to the trustee in bankruptcy the same right to avoid transfers as an unsecured creditor under applicable state law." In Re Harbour, 845 F.2d 1254, 1255 (4th Cir. 1988). See also In Re Graham, 747 F.2d 1383, 1386 (11th Cir. 1984) (bankruptcy trustee invoking O.C.G.A. § 18-2-22 to avoid transfer under § 544(b)).

Invoking § 544(b), Munford asserts that the LBO payments to the shareholder defendants constituted fraudulent conveyances under O.C.G.A. § 18-2-22. That section provides that "[e]very voluntary deed or conveyance, not for valuable consideration, made by a debtor who is insolvent at the time of the conveyance" is "fraudulent in law against creditors and others and as to them shall be null and void." O.C.G.A. § 18-2-22(3). Thus, Munford asserts that it did not receive valuable consideration in exchange for its payment of $17.00 per share to all of its outstanding shareholders. In essence, Munford contends that it received nothing of value in exchange for the debt it incurred in order to effectuate the LBO.

While § 544(b) authorizes a bankruptcy trustee (or debtor in possession acting as trustee) to avoid transfers that are avoidable under state law, that authority is restricted by 11 U.S.C. § 546(e). That section states that

> [n]otwithstanding section[ ] 544 . . . of this title, the trustee may not avoid a transfer that is . . . **a settlement payment**, as defined in section 101(35) or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title."

11 U.S.C. § 546(e) (emphasis supplied). Section 741(8) defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in securities trade." 11 U.S.C. § 741(8). Section 546(e), therefore, precludes the avoidance of "settlement payment" transfers made by or to a stockbroker or financial institution.

As did the bankruptcy court, this court recognizes the conflict of authority on the question of whether payments made to shareholders pursuant to an LBO transaction are settlement payments under § 546(e). In Kaiser Steel Corporation v. Charles Schwab Co., 913 F.2d 846 (10th Cir. 1990) (Kaiser I), the Tenth Circuit considered the application of § 546(e) to LBO payments made to stockbrokers and other financial intermediaries holding shares not as beneficial owners but merely as representatives of its clients (the actual beneficial shareholders). The court construed the term "settlement payment" broadly, finding its expansive construction of the term justified by: (a) a natural reading of the statutes involved, (b) the legislative intent behind § 546(e) "to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions," (c) and the understanding of the term "settlement" in the securities industry. See Id. at 848-49. Lastly, the court concluded that, in the absence of any limiting language in the definition of "settlement payment" in the relevant statutes, to impose such a limitation "would be an act of judicial legislation." Id. at 850. Having justified its expansive reading of the term "settlement payment," the Kaiser I court held that LBO payments made to stock-

brokers holding shares for the beneficial owners are settlement payments and are thus excluded from avoidance under § 546(e).

In In Re Kaiser Steel Corp., 952 F.2d 1230 (10th Cir. 1991), cert. denied, 112 S. Ct. 3015 (1992) (Kaiser II), the Tenth Circuit addressed an issue that was not raised in Kaiser I: whether LBO payments to beneficial shareholders are excluded under § 546(e). Applying the same expansive definition of "settlement payment" used in Kaiser I, the Kaiser II court held that the settlement payment exemption extends to LBO payments made directly to shareholders, even if no financial intermediary (e.g. stockbroker) is involved. Id. at 1239-40. Thus, Kaiser II held that § 546(e) precludes recovery of LBO payments from beneficial shareholders.

In contrast to the Tenth Circuit's rulings in Kaiser I and Kaiser II, the district court in Wieboldt Stores v. Schottenstein, 131 Bankr. 655 (N.D. Ill 1991), examined the legislative intent behind § 546(e) and concluded that "Congress exempted settlement payments in the commodities (and later the securities) industry out of concern that the bankruptcy of one party in the clearance and settlement chain could spread to other parties in that chain." Id. at 664. Based on this more narrow understanding of the intent behind the statute, the Wieboldt court concluded that the purpose of § 546(e) did not warrant applying the exemption to payments made to beneficial shareholders. Id. at 664-65.

As did the court in Wieboldt, the bankruptcy court found that the "clearance and settlement chain" generally used in securities transactions was not implicated by the LBO transaction. The bankruptcy court also con-

curred in Wieboldt's interpretation of the legislative history of § 546(e) and the objective of the settlement payment exemption. Accordingly, the bankruptcy court concluded that § 546(e) does not prohibit avoidance of payments made to shareholders. (Opinion of bankr. court [bankr. docket no. 611], April 4, 1994, at p. 38-40.)

Having considered the record before it and the parties' written objections and oral arguments, this court believes that the construction given to § 546(e) by the Tenth Circuit in Kaiser I, 913 F.2d 846, and Kaiser II, 952 F.2d 1230, is the better view. The broad definition of the term "settlement payment" advocated by the Kaiser courts is consistent with (a) the broad definition of "settlement payment" suggested by the statutes, (b) the intended function of the exemption as indicated by the general legislative history of the statute, and (c) the understanding of the term "settlement" in the securities industry. Accordingly, this court concludes that payments made to shareholders through a financial institution acting as a clearing or exchange agent pursuant to a LBO are settlement payments under § 546(e).

The plaintiff argues that even if LBO payments to shareholders are settlement payments, "each of the Directors and Officers against whom the fraudulent conveyance claim is brought, except Gardiner, held the Munford shares in his own name and thus did not receive payment through a broker or other securities intermediary." (P. response [bankr. docket no. 654] to Def. objections to bankr. court opinion at p. 48.) The court finds this argument unavailing for two reasons. First, it is apparent that even the officers and directors who personally tendered their Munford shares for redemption received payment by and through C & S Trust,

a "financial institution" acting as the exchange agent for the LBO. Indeed, the same facts were present in Kaiser II, 952 F.2d at 1236 (court noting that "some financial intermediaries and beneficial owners were required to tender their shares directly to Bank of America" which was the corporation's disbursing agent). Munford has failed to offer any grounds, nor is the court aware of any, to support a definition of "financial institution" that is so narrow as to exclude C & S Trust. Second, the court is satisfied that applying the "settlement payment" exclusion to payments made directly to shareholders "is justified by Congress's policy interests in promoting finality and 'in promoting speed and certainty in resolving complex financial transactions.'" Id. at 1240 n.10 (quoting H.Rep. No. 484, 101st Cong., 2d Sess. 2 (1990), reprinted in 1990 U.S.C.C.A.N. 223, 224).

In accordance with the foregoing, the court finds that 11 U.S.C. § 546(e) precludes Munford's action to avoid the payments made to its shareholders pursuant to the LBO. The shareholder defendants are therefore entitled to summary judgment on Count I.

B. Counts II & IV. In Counts II and IV, Munford seeks to hold the director defendants and defendant Carroll liable for breach of fiduciary duty and negligent mismanagement and waste of corporate assets. Specifically, Munford asserts that the defendants breached their duties to the corporation by approving and effecting the purchase of Munford via the LBO and by failing to consider the interests of other corporate constituents, namely creditors, when evaluating whether to accept the LBO offer. The defendants assert that their only obligation when considering the LBO was to maximize share-

holder value and that they are shielded from liability by the business judgment rule.

In its opinion recommending the denial of the defendants' summary judgment motions, the bankruptcy court recognized two potential sources of the defendants' duty: (1) the directors' duty to consider creditors' interests when a corporation is insolvent and (2) the duty incurred by the defendants specifically under Article IX of Munford's Articles of Incorporation (Article IX). Article IX states in relevant part as follows:

> [t]he board of directors of the corporation, when evaluating any offer of another person to make a tender or exchange offer for the Common Stock of the corporation, to merge or consolidate the corporation with another person, or to purchase or otherwise acquire all or substantially all of the properties and assets of the corporation, shall, in determining what is in the best interests of the corporation and its stockholders, given due consideration to all relevant factors, including without limitation . . . the social, legal and economic effects of the transaction on the employees, customers and other constituents of the corporation and its subsidiaries.

(Depo. exhibit 481.) The bankruptcy court denied the defendants' motion for summary judgment on these claims based on its conclusion that "the evidence establishes a question of fact as to whether the officer and director defendants considered all of the factors listed in Article IX." The bankruptcy court found that "[a] jury considering this evidence could find that the officer and director defendants either abused their discretion or acted in bad faith in violation of Article IX and the business judgment

rule." (Opinion of bankr. court [bankr. docket no. 611], April 4, 1994, at p. 50.)

In regard to directors' duty to creditors that arises pursuant to the insolvency of a corporation, the parties do not dispute that Munford was solvent prior to the LBO. The plaintiff asserts, however, that "[w]here a reasonably informed and engaged board of directors should have known that the transaction it was considering threatened the corporation's solvency, the directors' fiduciary obligation to the corporation requires the directors appropriately to address and evaluate the transaction's effect." (P. response [bankr. docket no. 654] to Def. objections to bankr. court opinion at p.54 (emphasis in original).) Whether Munford asserts that the directors owed a duty to the corporation and its constituents independent of Article IX is unclear. Regardless, however, of the source of the obligation, the essence of the plaintiff's claims is that the defendants were duty-bound to consider the impact that the proposed LBO would have on not just the shareholders but also upon the corporate entity itself and the corporation's constituents, including creditors.

While it is apparent that Article IX imposed an obligation upon the defendants, no one disputes that the directors clearly owed a duty to Munford's shareholders to maximize their return. To the extent that concerns about the transaction's impact on Munford's future financial condition were adverse to the present interests of the shareholders to receive top-dollar for their shares, the defendants were required to balance the competing interests. In striking that balance in favor of accepting the new purchasers' LBO proposal, the defendants are protected from liability by the business judgment rule.

"Under the business judgment rule[,] directors are presumed to have acted properly and in good faith[ ] and are called to account for their actions only when they are shown to have engaged in fraud, bad faith or an abuse of discretion." Cottle v. Storer Communication, Inc., 849 F.2d 570, 574 (11th Cir. 1988). "In the corporate takeover context, the business judgment rule applies once the directors have satisfied their duty to act in an informed and deliberate manner in determining whether to approve an agreement of merger . . . ." Id. at 575 (internal quotes omitted). Under former O.C.G.A. § 14-2-152.1 (1982), repealed by Ga. L. 1988, P. 1070, § 1 effective July 1, 1989, a director discharging his duties must act "[i]n good faith" and "[w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances." O.C.G.A. § 14-2-152.1(a)(1) (Michie Supp. 1988). Further, a director "is entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by: . . . [l]egal counsel, public accountants, investment bankers, or other persons as to matters the director reasonably believes are within the person's professional or expert competence." O.C.G.A. § 14-2-152.1(a)(2) (Michie Supp. 1988).

The undisputed factual record of this case makes apparent that the directors took every reasonable step that could be expected to evaluate the proposed LBO transaction. The record is replete with evidence that the defendants consulted with legal and investment banking experts, apprised themselves of the intricacies of the proposed transaction and about the background and reputation of the new purchases and new manager, and applied their own expertise and experience when evaluating the transaction.

Representatives from both King & Spalding, Munford's legal counsel, and Shearson Lehman Brothers, Munford's investment counsel, attended the directors' meetings on May 23, 1988, when the new purchasers' proposal was first announced (depo. exhibit 16 - minutes of directors' meeting 5/23/88), as well as subsequent meetings to consider the transaction on June 1, 1988 (depo. exhibit 17 - minutes of directors' meeting 6/1/88), June 7, 1988 (depo. exhibit 18 - minutes of directors' meeting 6/7/88) and August 9, 1988 (depo. exhibit 28 - minutes of directors' meeting 8/9/88). The minutes of the May 23, 1988 directors' meeting indicate that legal counsel discussed with the directors the requirements of Article IX of Munford's articles of incorporation. (Depo. exhibit 16 at p. 2.) (See also Rubright depo. at pp. 19-20, 138-41, referencing prior detailed examination of Article IX requirements with directors.) At that same meeting, counsel also informed the directors of all the terms of the tentative agreement that had been reached between Munford and the new purchasers. (Id.) Further, a representative of Shearson also addressed the directors regarding financing of the proposed transaction. Shearson noted to the directors on May 23, 1988 that the new purchasers were backed by an investment corporation with over $60,000,000 in assets and that Shearson was "favorably impressed with the apparent access to capital of [the new purchasers'] affiliates in other recent transactions . . . . The Directors then discussed further the background and financial capacity of F. Philip Handy and [his investment group]." (Id. at pp. 3-4.) The minutes of the June 7, 1988 directors' meeting indicate that Munford's legal counsel, after discussing the new purchasers' financing plan for the proposed purchase, ad-

vised the directors that they "could achieve certain comfort on post closing solvency of Munford Inc. in the event a reputable lender, such as Citibank, is willing to finance the transaction." (Depo. exhibit 18 at p.2.) The undisputed record also reflects that Munford's legal counsel informed the directors that Citicorp would perform and require a solvency analysis of post-acquisition Munford prior to financing the LBO. (Hopkins depo. at pp. 199, 210.) Lastly, Munford's attorneys secured from the new purchasers prior to closing the LBO a covenant that Munford would remain a solvent entity after the purchase. (See Rubright depo. at pp. 30-31.)

The record also plainly and repeatedly indicates that the directors relied on the presence of Citicorp as lender. The directors were obviously aware that Citicorp, as the primary lender for the new purchasers, would have access to the business plans and strategy that the new owners and managers of Munford planned to implement after the LBO. The director defendants uniformly cited Citicorp's involvement as an important indication that Munford would be able to make payment on its loans and remain solvent after the transaction. (See Pearson depo. at pp. 90-100; Ferguson depo. at p. 97; Gardiner depo. at p. 84; Rymer depo. at p. 118-119.)

There is also significant evidence that the directors evaluated not only the financial terms of the proposed transaction but also the new purchasers and the proposed new management team. As cited above, Shearson provided its opinion during the May 23, 1988 directors' meeting that the new purchasers had access to large amounts of capital from their affiliated companies. The minutes of that meeting also indicate that the directors themselves discussed Handy's background and the finan-

cial resources of the new purchasers. (Depo. exhibit 16 at p. 4.) The record also reflects that at the June 1, 1988 meeting Handy was personally questioned by the directors about the financing for the purchase. (Depo. exhibit 17 at p. 3.) The directors were also informed and evaluated the individual selected by the new purchasers to manage Munford after the transaction. By letter dated September 26, 1988 and addressed to all directors, Dillard Munford introduced Joe Leonardo as the purchasers' choice to run Munford's convenience store business after the purchase. The letter highlighted Leonardo's credentials including his responsibility for turning around another convenience store chain that had previously lost money. (Depo. exhibit 29.) Both directors Pearson and Gardiner considered Handy's sophistication and Leonardo's prior success in the business as indications that Munford would survive the transaction. (See Pearson depo. at 84-87, 100; Gardiner depo. at p. 114.)

Lastly, the record is replete with evidence indicating that the directors evaluated the transaction with the benefit of their own experience and information. Pearson, who was not a Munford stockholder, expressly considered the impact of the transaction on Munford's post-acquisition solvency. He felt strongly that Munford was in need of new management and that Munford could and would remain solvent if this was done. (Pearson depo. at pp. 65, 84.) Ferguson, also not a shareholder, expressly stated that he evaluated the proposed transaction by considering both the effect on the corporation as an entity and the individual shareholders. (See Ferguson depo. at pp. 31, 38-39.) Rymer acknowledged his obligation to consider a variety of factors when evaluating the transaction and indicated that he had no concern about Munford's

post-closing solvency. (Rymer depo. at pp. 120, 146-47.) Gardiner, too, stated that he had no reason to doubt the continued operation of Munford after the sale. (Gardiner depo. at p. 46.)

Based on the undisputed factual record summarized above, the court finds as a matter of law that the defendants fulfilled their obligation to consider all aspects of the proposed transaction. Indeed, the court is satisfied that the defendants took every reasonable step that they could have been expected to take in considering the LBO. Furthermore, the record is completely devoid of any indication that the defendants engaged in fraud, bad faith or an abuse of discretion. While the plaintiff urges that the defendants could or even should have decided against going forward with the LBO, the defendants exercise of business judgment cannot be evaluated in hindsight. The court finds as a matter of law, therefore, that the defendants did not breach any fiduciary duty and that they did not act negligently in evaluating the proposed LBO. Accordingly, the defendants are entitled to summary judgment as to the plaintiff's claims in Counts II and IV.

In the alternative to the court's analysis above, the court also finds that the plaintiff has failed to state a cause of action for the defendants' alleged violation of Article IX. The plaintiff has failed to bring to the court's attention, nor is the court independently aware of, any legal authority directly supporting the contention that a cause of action exists against the defendants for allegedly breaching their responsibility imposed under Article IX. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), relied upon by the plaintiff, does not even purport to create such a cause of action. Accordingly, the court finds that even if the defendants failed to comply

with their obligations under Article IX, such does not give rise to a private cause of action.

C. Count III. Munford asserts in Count III that the director defendants are liable for violating Georgia's corporate distribution laws. O.C.G.A. § 14-2-91 (1988), repealed by Ga. L 1988, p. 1070, § 1, effective July 1, 1989, prohibits the distribution to shareholders of a corporation's assets "at a time when the corporation is insolvent or when such distribution would render the corporation insolvent." Similarly, O.C.G.A. § 14-2-92 (1988), repealed by Ga. L 1988, p. 1070, § 1, effective July 1, 1989, prohibits a corporation from repurchasing its own shares at a time when the corporation is insolvent or would be rendered insolvent by the repurchase. The bankruptcy court denied the defendants' motion for summary judgment on the grounds that issues of fact existed as to the nature of the LBO transaction. Specifically, the bankruptcy court found that "a jury could conclude that [the LBO] was a distribution or share repurchase transaction." (Opinion, [bankr. docket no. 611], April 4, 1994 at p. 53.)

The defendants urge this court to follow C-T of Virginia, Inc. v. Barrett, 958 F.2d 606 (4th Cir. 1992), in which the Fourth Circuit rejected a plaintiff's attempt to apply Virginia's corporate distribution statute to recapture payments made to shareholders pursuant to an LBO structured similarly to the one at issue. In short, the court premised its decision on its conclusion that "[a] corporate acquisition, structured as a merger, is simply a different animal from a distribution." Id. at 611. The bankruptcy court rejected the reasoning of C-T of Virginia, stating that "the distribution and share repurchase statutes of the Georgia Code clearly were intended to

protect creditors by prohibiting transfers at a time when a corporation is insolvent or would be rendered insolvent. Such intent furthers the longstanding principal that creditors are to be paid before shareholders." (Opinion [bankr. docket no. 611], April 4, 1994, at p. 53.)

At this juncture of the litigation, this court agrees with the bankruptcy court and declines to follow the Fourth Circuit's decision in C-T of Virginia. Whether or not Georgia's corporate distribution laws were violated causing Munford's bankruptcy is an issue of fact and is not susceptible to summary adjudication. Accordingly, the director defendants' motion for summary judgment is not warranted as to Count III.

D. Count V. Munford asserts in Count V that severance payments made to defendants Dillard Munford, Fellows and Carroll are void as fraudulent conveyances under O.C.G.A. § 18-2-22(3). That section provides that "[e]very voluntary deed or conveyance, not for valuable consideration, made by a debtor who is insolvent at the time of the conveyance" is "fraudulent in law against creditors and others and as to them shall be null and void." O.C.G.A. § 18-2-22(3). Defendants Dillard Munford, Fellows and Carroll assert that the severance payments made to them subsequent to the LBO were in consideration for their continued employment as officers of Munford up to the time of the LBO.

In order to recover on this claim, Munford must establish three elements: (1) the conveyance of its property (the severance payments) to the defendants, (2) that the conveyances were "voluntary," i.e. not for valuable consideration, and (3) that Munford was insolvent at the time of the payments or was rendered insolvent thereby.

See Brown v. Citizens & Southern National Bank, 253 Ga. 119, 122, 317 S.E.2d 180 (1984). Georgia courts have long and uniformly held that the term "voluntary" as used in the fraudulent conveyance statute is not used in its ordinary meaning of "free choice" as opposed to "compelled"; rather, "a voluntary conveyance or deed is one without any valuable consideration." Id. "[V]aluable consideration is founded on money or something convertible into money, or having value in money." Stokes v. McRae, 247 Ga. 658, 659, 278 S.E.2d 393 (1981).

It is apparent that the instant defendants received a transfer of money from the plaintiff thus satisfying the first element of the claim. Further, the parties do not dispute the existence of a factual dispute as to the third element of the instant claim—whether Munford was insolvent at the time it was obligated to make the payments or was rendered insolvent thereby. Accordingly, the merit of the defendants' motion as to this claim turns on whether the severance payments they received were supported by valuable consideration. In denying the defendants' summary judgment motion, the bankruptcy court found that Munford had come forward with sufficient evidence to support a jury determination that the payments to the defendants were merely "gifts" given in appreciation for past efforts and not supported by valuable consideration.

The defendants assert that they are entitled to summary judgment because Munford received valuable consideration in return for the severance payments as a matter of law. Specifically, the defendants contend that Munford received valuable consideration in the form of continued employment by the defendants during 1987, when Munford was pursuing bidders to purchase 100%

of its outstanding stock, and 1988, when Munford was negotiating the LBO. This circuit has recognized that a corporation receives a "bona fide" benefit from a "golden parachute" provision that serves to eliminate the threat that an officer will depart the company due to an imminent or likely sale or takeover of the corporation. See International Ins. Co. v. Johns, 874 F.2d 1447, 1462-67 (11th Cir. 1989). Furthermore, Georgia law has expressly recognized that "[c]ontinued performance under a terminable-at-will contract furnishes sufficient consideration for the promise of additional severance pay." Royal Crown Cos. v. McMahon, 183 Ga. App. 543, 545, 359 S.E.2d 379 (1987). In accordance with this authority, if such continued performance was provided to Munford by the defendants as consideration for the severance payments at issue, the defendants are entitled to summary judgment.

The plaintiff asserts, however, that there is evidence indicating that the defendants did not promise continued employment in exchange for the severance provisions. Having considered the evidence cited by both the bankruptcy court and the plaintiff, the court finds that it is not sufficient to raise a genuine issue of fact as to this claim. Section 9 of the defendants' original employment contracts with Munford, under which the severance terms at issue arose, provided for severance payments to the employee upon the termination of the employment contract by Munford's directors (or with the directors' approval). Dillard Munford and Fellows's original employment contracts were dated January 11, 1979; Carroll's original employment contract was dated September 21, 1987. As the purchase of Munford in the LBO grew increasingly more likely, the directors approved (see

depo. exhibit 18 at pp. 6-7) and Munford and the defendants agreed to amend the terms of Section 9 of the original employment contract to state that the contract of employment was terminable by either party upon the consummation of the LBO transaction with the new purchasers. Upon such termination, the severance payments would be payable substantially as called for under the original contract. These amendments were entered into in June and again in August of 1988, several months prior to the consummation of the LBO on November 29, 1988.

The court finds as a matter of law that the severance payments provided for in the defendants' employment contracts were given in exchange for valuable consideration—such being the defendant's continued employment. The original employment contracts clearly provided that the severance payments would only be paid in the event of the employee's termination by (or with the express approval of) Munford. As amended several months prior to the consummation of the LBO, the contracts permitted either the employee or Munford to terminate the contract with full severance benefits, **but only after the consummation of the LBO.** In essence, the defendants could only obtain the severance benefits by continuing to work for Munford up to the time of the LBO transaction. The employment contract terms make it clear that the severance benefits paid to the defendants were conditioned on their continued employment.

Such terms are logically and as a matter of law inconsistent with the plaintiff's contention that the severance payments were gifts to the defendants. The evidence offered by the plaintiff in support of its contention that the severance payments were mere gifts is

contrary to the plain terms and meaning of the defendants' employment contracts and is insufficient to raise a genuine issue of fact on this issue. Accordingly, the defendants are entitled to summary judgment as to Count V.

Summary

The motion for summary judgment by the DFA entities [bankr. docket no. 422] is GRANTED. The plaintiff's claims against the DFA entities stated in Count I are hereby DISMISSED.

The motion for summary judgment by the outside director defendants Gardiner, LeBlond, Dickson, Blount, Rymer, Pearson, and Ferguson [bankr. docket no. 482] is GRANTED in part and DENIED in part. The motion is GRANTED as to Counts I, II and IV. The plaintiff's claims against the outside director defendants stated in Counts I, II and IV of the plaintiff's complaint are hereby DISMISSED. The motion is DENIED as to the plaintiff's claims against the outside director defendants stated in Count III.

The motion for summary judgment by defendant Dillard Munford [bankr. docket no. 505] is GRANTED in part and DENIED in part. The motion is GRANTED as to Counts I, II, IV and V. The plaintiff's claims against defendant Dillard Munford stated in Counts I, II, IV and V of the plaintiff's complaint are hereby DISMISSED. The motion is DENIED as to the plaintiff's claims against defendant Dillard Munford stated in Count III.

The motion for summary judgment by defendants Fellows and Carroll [bankr. docket no. 508] is GRANTED

in part and DENIED in part. The motion is GRANTED as to Counts I, II, IV and V. The plaintiff's claims against defendants Fellows and Carroll stated in Counts I, II, IV and V of the plaintiff's complaint are hereby DISMISSED. The motion is DENIED as to the plaintiff's claims against defendants Fellows and Carroll stated in Count III.

The motion for summary judgment by defendants Hardin and Rubel [docket no. 510] is GRANTED. The plaintiff's claims against defendants Hardin and Rubel stated in Count I are hereby DISMISSED.

SO ORDERED, this 10th day of August, 1994.

/s/ G. Ernest Tidwell
G. ERNEST TIDWELL
JUDGE, UNITED STATES DISTRICT COURT

[Dated April 4, 1994]

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	
MUNFORD, INC., d/b/a MAJIK MARKET, Debtor.	CASE NO. A90-00078-SWC CHAPTER 11
MUNFORD, INC., Plaintiff,	
vs.	ADVERSARY NO. 91-6417
DILLARD MUNFORD; RUSSELL C. FELLOWS; WINTON M. BLOUNT; HERBERT J. DICKSON; JAMES L. FERGUSON; ROBERT M. GARDINER; RICHARD K. LeBLOND II; ANDRALL E. PEARSON; S.B. RYMER, JR.; JAMES M. CARROLL; JOSEPH W. HARDIN; JAY E. RUBEL; PROVIDENT NATIONAL BANK, as Trustee for the DFA GROUP TRUST; STATE STREET BANK & TRUST COMPANY, as Trustee for the DFA GROUP, as Trustee for the DFA GROUP TRUST; DFA INVESTMENT DIMENSIONS GROUP, INC.; VALUATION RESEARCH CORPORATION and SHEARSON LEHMAN BROTHERS INC., Defendants.	

OPINION

Before the court are motions for summary judgment filed by the defendants as follows: (1) DFA Investment Dimensions Group Inc. ("DFA Fund"), Provident Nation-

al Bank, as trustee of the DFA Group Trust, and State Street Bank & Trust Company, as trustee of the DFA Participating Group Trust ("DFA Trusts") (collectively referred to herein as "DFA Entities"); (2) Dillard Munford; (3) outside directors Winton M. Blount, Herbert J. Dickson, James L. Ferguson, Robert M. Gardiner, Richard K. LeBlond II, Andrall E. Pearson, and S.B. Rymer, Jr.; (4) Jay E. Rubel and Joseph Hardin; and (5) James M. Carroll and Russell C. Fellows. Also, before the court is a motion for partial summary judgment and to strike, certain affirmative defenses filed by plaintiff, Munford, Inc. ("Munford"), and motions to strike Munford's responsive statement of material facts and to strike the Declaration of Neal S. Berinhout filed by defendants Carroll, Fellows, Hardin and Rubel.[1] This adversary proceeding involves both non-core and core matter claims pursuant to 28 U.S.C. § 157. The court's proposed findings of fact and conclusions of law are set forth hereinafter.

FACTS

Munford was a specialty retailer with three primary business units: (1) Majik Market; (2) World Bazaar; and (3) LeeWards Creative Crafts. In addition, Munford owned 50.4% of the outstanding shares of United Refrigerated Services, Inc. Munford's principal business was its chain of Majik Market stores.

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[1] Defendant, Shearson Lehman Brothers, Inc., also filed a motion for summary judgment which is addressed in a separate opinion entered even date herewith. Any issues in Munford's motion for partial summary judgment that relate to Shearson will also be addressed in the separate opinion.

Prior to November 29, 1988, Munford was a publicly-held Georgia corporation founded by defendant Dillard Munford. Throughout 1987 and until November 29, 1988, various defendants herein served as officers or directors of Munford. The officers consisted of Dillard Munford, Chief Executive Officer; Russell C. Fellows, President and Chief Operating Officer; James M. Carroll, Executive Vice President and Secretary; Joseph W. Hardin, Vice President and Treasurer; and Jay E. Rubel, Vice President/Administration. The directors consisted of Dillard Munford, Chairman; Russell C. Fellows; and outside directors, Robert M. Gardiner, Richard K. LeBlond II, Herbert J. Dickson, Winton M. Blount, S.B. Rymer, Jr., Andrall E. Pearson, and James L. Ferguson (collectively referred to as the "outside directors"). At all relevant times, each of the officers were shareholders of Munford and controlled options to purchase additional shares. Also, outside directors Dickson, Gardiner, LeBlond, and Rymer were shareholders of Munford.

Defendants, DFA Entities, are former shareholders of Munford whose shares were tendered and purchased in the LBO.[2] On November 29, 1988, DFA Entities beneficially owned 234,158 shares of Munford common stock.[3]

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[2] The DFA Fund is a registered open-end management company, commonly referred to as a mutual fund. The shares of this fund are primarily owned by tax-exempt institutional investors who, for the most part, are qualified pension and profit sharing plans holding assets for the benefit of retirees. The DFA Trusts are investment vehicles whose participants are, like the owners of the DFA Fund, tax-exempt and profit sharing plans.

[3] Some of the current shareholders and participants in the DFA Fund and DFA Trusts did not hold their interests in

(continued...)

In August of 1987, Munford's board of directors retained the services of defendant Shearson Lehman Brothers, Inc. ("Shearson") to evaluate Munford and to make recommendations regarding its future. In September of 1987, Shearson presented a written financial report analyzing the alternatives available to Munford to maximize shareholder value. (Deposition Exhibit No. 5). It concluded that ". . . the sale of 100% of [Munford's] common stock is the most effective means of maximizing shareholder value . . . ." Based on its analysis of Munford's historical and projected operating results, Shearson further concluded that a leveraged buyout or leveraged recapitalization would not be a feasible alternative to maximize shareholder value. (Id. at Sec. V). After reviewing Shearson's financial report, the directors authorized Shearson to prepare an offering memorandum and to solicit potential purchasers.

Shearson approached approximately 160 potential buyers, distributed the memorandum to approximately 80 potential buyers, and received 14 preliminary bids. None of these bids came to fruition, although there was an unsuccessful effort to negotiate a leveraged buyout with Deutschman & Co., one of these bidders.

Thereafter, F. Philip Handy, an individual financier, organized a group of investors (collectively referred to as the "new investors") to acquire all of Munford's stock for

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[3] (...continued)
November of 1988. Likewise, some of the shareholders and participants in November of 1988 are not currently shareholders or participants.

$18.50 per share.[4] The new investors presented a proposed agreement in principal to acquire Munford by a leveraged buyout ("LBO"). This proposal was considered by Munford's board of directors on May 23, 1988. At this meeting, James Rubright, counsel for Munford, discussed the proposal and explained the factors set forth in Article IX of Munford's articles of incorporation to be considered by the directors in evaluating the proposal.

Munford's board of directors unanimously approved the proposed agreement and began pursuing a definitive agreement. On June 1, 1988, Munford's board of directors considered the financing arrangements of the new investors. Mr. Handy, who was present for part of this meeting, indicated that financing for the proposed purchase would come from commercial banks with as little equity participation by himself and his group as possible.

To accomplish the LBO, the new investors formed Alabama Acquisition Corporation ("AAC") and Alabama Merger Corporation ("AMC"), a wholly owned subsidiary of AAC. It was agreed that AMC and Munford would merge, with Munford being the survivor. Both AAC and AMC were shell corporations. At the May 23 meeting, Rubright informed the directors of this fact.

In consideration a loan commitment for the proposed LBO, Citicorp, N.A. ("Citicorp") prepared an internal sol-

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[4] The new investors included the following: (1) Handy; (2) Panfida Limited, an Australian corporation involved in the business of investing in other corporations; (3) "Investing in Success" Equities Plc, an investment trust company organized under the laws of the United Kingdom and involved in the business of investing in both public and private companies; and (4) Panfida USA, Inc., a Florida corporation and a wholly owned subsidiary of Panfida Limited.

vency analysis of post-merger Munford and concluded that the proposed merger/LBO transaction would not render Munford insolvent. Thereafter, it retained Valuation Research Corporation ("Valuation Research") to prepare a solvency opinion. Valuation Research also concluded that Munford would not be rendered insolvent following the merger/LBO transaction.

On August 9, 1988, Munford's directors approved and the parties executed the Amended and Restated Agreement and Plan of Merger ("Merger Agreement") which reduced the purchase price to $17 for each share of Munford's common stock.[5] This Agreement provided in section 3.2(b) that AAC and AMC, would ". . . deposit or cause to be deposited in trust with an Exchange Agent," mutually acceptable to AAC and Munford, sufficient cash to purchase Munford's outstanding common stock at $17 per share. The Merger Agreement further provided that these funds could not be used for any other purpose and required both AAC and Munford to give the Exchange Agent irrevocable written instructions to make the cash payments to shareholders as provided in section 3.2(a). (Deposition Exhibit No. 1, Merger Agreement, section 3.2(b)). Citizens & Southern Trust Company (Georgia), N.A. ("Citizens & Southern Trust"), a trust company, was employed to serve as the Exchange Agent.

Citicorp issued a commitment to AAC and Wicker Corporation ("Wicker"), an affiliate of the new investors, to provide financing consisting of a $54.8 million revolv-

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[5] At this meeting, Shearson delivered a written report stating its preliminary opinion that the purchase price of $17 per share was fair from a financial point of view to Munford's shareholders.

ing credit loan facility to Munford and a $14 million revolving credit loan facility and a $3 million term loan to World Bazaar, Inc. ("World Bazaar") for a total of $71.8 million. The Citicorp commitment required that its total financing be secured by all of Munford's and World Bazaar's assets with Munford unconditionally guaranteeing World Bazaar's loans. The World Bazaar loan facility was intended to permit Wicker to purchase World Bazaar. However, the purchase and sale of World Bazaar was not a condition of the Merger Agreement. (Deposition Exhibit No. 1, Merger Agreement at section 9.6). Nevertheless, the proceeds of this asset sale were used by Munford to partially fund the LBO.

On November 29, 1988, AAC acquired Munford through a $90,604,348.63 LBO.[6] Only $550,000 in new capital was received by Munford as a result of the merger of AMC. There was a corresponding requirement for the payment of a $550,000 fee to an AAC affiliate,

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[6] The sources of funding for the LBO was as follows:

Source	Amount
Munford Cash	$14,238,000
AMC Cash	550,000
Proceeds of Munford Citicorp Loans	53,244,000
Munford Redemption of C&S CD's (insurance trade L/C)	2,700,000
Proceeds of Purchase Money Note for Sale of World Bazaar	18,000,000
Proceeds of World Bazaar Intra Company Receivables Note	3,100,000
WBI Contribution for Closing Costs	650,000
Total	$92,482,000

(Deposition Exhibit No. 378).

Winter Park Capital. The receipt of these funds and payment of this fee occurred simultaneously.

In a draw request dated November 29, 1988, F. Philip Handy as chairman of Munford, Inc., requested initial Munford borrowings from Citicorp of $53,244,000.[7] The request directed the transfer of $26,580,814.58 of the Citicorp loan proceeds to Munford, Inc. account #00168005 at The Citizens and Southern National Bank ("C&S"). Munford then transferred $61,811,235 from its C&S account #00168005 to Citizens & Southern Trust, the Exchange Agent. These funds were used to purchase Munford's outstanding shares of common stock at $17 per share, except for AAC or AMC shares. Additionally, a portion of the LBO closing costs and creditor claims were also paid from the C&S account. This left a balance of $2,454,569.08 in Munford's account. The balance of the Citicorp loan proceeds were disbursed by Citicorp pursuant to Munford's draw request to pay various claims of existing Munford creditors or other loan and LBO closing costs. (Deposition Exhibit No. 378).

On November 29, 1988, in a series of simultaneous transactions, the LBO was consummated by the Merger of AMC and Munford, with Munford emerging as the surviving corporation. As provided in section 3.1(a) of the Merger Agreement, all shares of Munford common stock owned by AMC were retired with no consideration exchanged for such shares. The remaining 3.9 million outstanding shares were converted into the right to receive $17 per share.

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[7] This left Munford with an unused line of credit availability of $1,556,000.

On January 2, 1990, Munford filed for bankruptcy protection under Chapter 11. On June 17, 1991, Munford filed its complaint for the benefit of Munford's estate and its unsecured creditors.[8] On July 23, 1992, Munford filed its amended and restated complaint.

DISCUSSION

Federal Rule of Civil Procedure 56, made applicable by Bankruptcy Rule 7056, provides for the granting of summary judgment if ". . . there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). A fact is material if it ". . . might affect the outcome of the suit under the governing (substantive) law . . . ." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1985). A dispute of fact is genuine ". . . if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Id. The moving party has the burden of establishing the right of summary judgment. Clark v. Coats & Clark, Inc., 929 F.2d 604, 608 (11th Cir. 1991); Clark v. Union Mut. Life Ins. Co., 692 F.2d 1370, 1372 (11th Cir. 1982); United States Steel Corp. v. Darby, 516 F.2d 961, 963 (5th Cir. 1975).

In determining whether there is a genuine issue of material fact, the court must view the evidence in the light most favorable to the party opposing the motion. Adickes v. S. H. Kress & Co., 398 U.S. 144, 157 (1970); Rosen v. Biscayne Yacht & Country Club, Inc., 766 F.2d

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[8] Munford as a debtor in possession is authorized to exercise powers of a trustee under 11 U.S.C. § 1107(a), with certain non-relevant exceptions.

482, 484 (11th Cir. 1985); United States v. Oakley, 744 F.2d 1553, 1555 (11th Cir. 1984). The moving party must identify those evidentiary materials listed in Federal Rule 56(c) that establish the absence of a genuine issue of material fact. Celotex Corp. v. Catrett, 477 U.S. 317, 323-24 (1986); see also Fed. R. Civ. P. 56(e). Once the motion is supported by a prima facie showing that the moving party is entitled to judgment as a matter of law, a party opposing the motion must go beyond the pleadings and demonstrate that there is a material issue of fact which precludes summary judgment. Celotex, 477 U.S. at 324; Coats & Clark, 929 F.2d at 608.

Defendants Carroll, Fellows, Hardin, and Rubel have moved to strike Munford's responsive statement of material facts. They assert that Munford's statement does not comply with Local Rule 220-5(b)(2) because Munford failed to attach to its response a separate statement of material facts as to which it contends there exists a genuine issue to be tried. This contention is without merit. The last three pages of Munford's statement indicate which of the defendants' joint statement of facts are disputed and which are undisputed. With regard to the disputed facts, Munford references the relevant paragraphs in its statement in which it contends that there are genuine issues to be tried.

These defendants also contend that the majority of Munford's stated facts are legal arguments or conclusions. However, defendants have not identified with specificity the objectional paragraphs or the legal arguments. While several paragraphs in Munford's statement contain legal argument, the court does not find that Munford's statement prejudices defendants in any material way. Moreover, the court will disregard the legal

arguments and conclusions within the statement of facts. Thus, the motion to strike Munford's statement should be denied.

Next, Munford has moved for partial summary judgment and to strike several affirmative defenses asserted by defendants as follows: (1) Munford participated in the transaction and was the grantor of the fraudulent conveyance;[9] (2) Munford is estopped from asserting its claims;[10] (3) Munford's lack of standing;[11] (4) the doctrine of laches;[12] (5) Munford's failure to join indispensable parties;[13] and (6) Munford's claims are barred by its settlement agreement with TOC Retail, Inc.[14]

In support of its motion, Munford filed a statement of undisputed facts based upon a document entitled "Declaration of Neal S. Berinhout." Defendants Carroll, Fellows, Hardin, and Rubel have moved to strike the Berinhout declaration contending that the statements therein are conclusory and an attempt to substitute the judgment of Munford's counsel for that of the trier of fact. The court agrees.

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[9] See Fourth Defense of DFA Entities.

[10] See Second Defense of Carroll and Fellows; Sixth Defense of DFA Entities, Eighth Defense of Hardin and Rubel; Eleventh Defense of Ferguson and Pearson; Twelfth Defense of Dillard Munford, Blount, Dickson, Gardiner, LeBlond, and Rymer.

[11] See Fourth and Fifth Defense of DFA Entities.

[12] See Third Defense of DFA Entities; Eleventh Defense of Carroll, Fellows, Hardin, and Rubel.

[13] All of the defendants assert the defense that Munford has failed to join indispensable parties.

[14] See Tenth Defense of Hardin and Rubel.

Rule 56(e) provides that supporting or opposing affidavits must be made on personal knowledge, must set forth facts that would be admissible in evidence, and must show affirmatively that the affiant is competent to testify to the matters stated therein. Fed. R. Civ. P. 56(e). An affidavit submitted pursuant to Rule 56(e) may not properly set forth the following: (1) ultimate or conclusory facts; (2) conclusions of law; (3) statements made on belief or "on information and belief;" and (4) hearsay testimony and opinion testimony which would be inadmissible at trial. See 10A C. Wright, A. Miller, & M. Kane, Federal Practice and Procedure Civil 2d, § 2738, p. 486-489 (1983); 6 J.W. Moore, Moore's Federal Practice, ¶ 56-22[1] (2nd ed. 1988).

The Berninhout declaration improperly sets forth ultimate or conclusory facts and conclusions of law based on the opinion of counsel. The court concludes, therefore, that this declaration should be stricken. Munford has not otherwise supported its motion and has failed to carry its initial burden of proof. See Celotex, supra, 477 U.S. at 323-24. Accordingly, Munford's motion for partial summary judgment should be denied.

Next, Munford seeks to strike certain defenses asserted by defendants. Pursuant to Federal Rule of Civil Procedure 12(f), made applicable by Federal Rule of Bankruptcy Procedure 7012(b), "the court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent, or scandalous matter." Fed. R. Civ. P. 12(f). While courts have broad discretion in resolving motions to strike, such motions are not favored by the federal rules. See Resolution Trust Corp. v. Youngblood, 807 F.Supp. 765, 769 (N.D. Ga. 1992). As noted in Resolution Trust:

> [w]here a defense is insufficient as a matter of law, it should be stricken to eliminate the unnecessary delay and expense of litigating it. However, "motions to strike can not be used to determine disputed fact questions, nor can they be used to decide disputed and substantial questions of law, particularly when there is no showing of prejudice to the movant."

Id. at 769 (citations omitted).

Various defendants herein have withdrawn or agreed that certain of their defenses are not available as follows: (1) Tenth Defense of Dillard Munford, Ferguson, Pearson, Blount, Dickson, Gardiner, LeBlond, and Rymer based on Federal Rule of Civil Procedure 9(b); (2) Third Defense of Carroll and Fellows, Ninth Defense of Hardin and Rubel; Twelfth Defense of Ferguson and Pearson; and Thirteenth Defense of Blount, Dickson, Gardiner, LeBlond, Rymer and Dillard Munford based on failure to join indispensable parties; (3) the "unclear hands" defense set forth in the Eleventh Defense of Hardin and Rubel; and (4) Tenth Defense of Hardin and Rubel based on Munford's claims being barred by the settlement with TOC Retail, Inc. Each of these defenses should be stricken.

Dillard Munford, Carroll, Fellows, Hardin, Rubel, and the outside directors assert as defenses that Munford has waived the right to maintain this action due to the shareholders' approval of the LBO and Munford's knowledge of, consent to, and acquiescence in the LBO bar recovery. Further, DFA Entities assert that Munford's claims are barred by the doctrine of "unclean hands." However, defendants have not cited and this court has not found authority to support these defenses. It is a

fundamental principal of corporate law that "[a]s a legal entity, a corporation is separate and distinct from its officers, stockbrokers, and agents." See Casey v. Carrollton Ford Co., 152 Ga. App. 105, 106, 262 S.E.2d 255 (1979). In addition, officers and directors may be liable for breaches of fiduciary duties owed to a corporation. See Quinn v. Cardiovascular Physicians, P.C., 254 Ga. 216, 217, 326 S.E.2d 460 (1985). As such, the actions of Munford's former officers and directors as well as its former shareholders cannot waive the claims of Munford against said officers and directors. Accordingly, the court concludes that the "waiver" and "unclean hands" defenses are insufficient as a matter of law and should be stricken.

Defendants Hardin and Rubel also assert the defense of in pari delicto which bars an action where the parties are equally culpable. Defendants do not indicate how Munford or its creditors were equally culpable for the acts or omissions of defendants, and have cited no authority to support this position. As such, this defense is insufficient as a matter of law. Accordingly, the court concludes that the in pari delicto defense set forth in the Eleventh Defense of Hardin and Rubel should be stricken.

Only DFA Entities continue to assert a failure to join indispensable parties. This defense is based on Federal Rule of Civil Procedure, made applicable by Federal Rule of Bankruptcy Procedure 7019. DFA Entities, however, have failed to demonstrate that the addition of other parties is necessary for a just adjudication of Munford's claims against them. The complaint seeks to recover alleged fraudulent conveyances and no additional parties appear necessary for this determination. The court,

therefore, concludes that this defense is insufficient as a matter of law and should be stricken.

DFA Entities assert a lack of bankruptcy court jurisdiction to conduct a jury trial of Munford's fraudulent conveyance claim. See Granfinanciera S.A. v. Nordberg, 492 U.S. 33 (1989). Munford agrees. The majority of circuit courts that have considered this issue have concluded that the bankruptcy courts are without jurisdiction to conduct jury trials. See In re Grabill Corp., 976 F.2d 1126, 1127 (7th Cir. 1992); In re Baker & Getty Fin. Servs., Inc., 954 F.2d 1169, 1173 (6th Cir. 1992); In re Kaiser Steel Corp., 911 F.2d 380, 392 (10th Cir. 1990); In re United Mo. Bank of Kansas City, N.A., 901 F.2d 1449, 1453-57 (8th Cir. 1990). See also Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1101 (2d Cir. 1993) (Second Circuit held that the Constitution prohibits bankruptcy courts from holding jury trials in non-core matters); but see In re Ben Cooper, Inc., 896 F.2d 1394, 1402-04 (2d Cir. 1990), cert. granted, 497 U.S. 1023, 110 S.Ct. 3269, 111 L.Ed.2d 779, vacated and remanded on other grounds, 498 U.S. 964, 111 S.Ct. 425, 112 L.Ed.2d 408 (1990) reinstated, 924 F.2d 36, cert. denied, ___ U.S. ___, 111 S.Ct. 2041, 114 L.Ed.2d 126 (1991) (Second Circuit held that bankruptcy court has power to hold jury trials in core proceedings). This court agrees with the majority. Munford has otherwise withdrawn its motion to strike DFA Entities' Second Defense.

Only defendants Carroll, Fellows, Hardin, and Rubel continue to assert an affirmative defense based on Federal Rule of Civil Procedure 9(b), made applicable by Federal Rule of Bankruptcy Procedure 7009. Rule 9(b) provides that "[i]n all averments of fraud or mistake, the

circumstances constituting fraud or mistake shall be stated with particularity." These defendants contend that there are no allegations in the amended complaint which indicate that fraud or bad acts of any type were committed. Munford's amended complaint alleges and describes the events leading to and culminating in the LBO and that:

> [t]he payments by . . . Munford to each of the [s]hareholder [d]efendants for their shares and for options constituted fraudulent conveyances in violation of O.C.G.A. § 18-2-22(3), because . . . Munford did not receive valuable consideration for the payments made, and because it was insolvent at the time, or rendered insolvent, having insufficient funds with which to pay its debts as they become due and having remaining property of insufficient value to satisfy its debts in full.

(Amended Complaint at 89). Under notice pleading, Munford has alleged its fraudulent conveyance claim with sufficient particularity. To establish its claim, Munford need only prove the requisite elements of O.C.G.A. § 18-2-22(3). See Loeb v. Dante, (In re Dante), 1 B.R. 547, 548-49 (Bankr. N.D. Ga. 1979). Once these elements are proven, ". . . the law conclusively presumes a fraudulent intent and declares the [transfer] void . . . ." Mercantile Nat. Bank v. Aldridge, 233 Ga. 318, 321, 210 S.E.2d 791 (1974); see also Neal v. Stapleton, 203 Ga. 236, 243, 46 S.E.2d 130 (1948). Consequently, it is unnecessary for Munford to plead facts in its amended complaint which show a "fraudulent intent" or bad acts on the part of any defendant. The Sixth Defense of Carroll, Fellows, Hardin, and Rubel should be stricken.

The court will now address the various summary judgment motions of the defendants as they relate to the counts of Munford's amended complaint.

I. COUNT I

In Count I, Munford asserts that the payments to shareholders for their shares in connection with the Munford LBO constitute fraudulent conveyance in violation of O.C.G.A. § 18-2-22(3). The shareholder defendants named in Count I are Dillard Munford, Fellows, Dickson, Gardiner, LeBlond, Rymer, Carroll, Hardin, Rubel, and DFA Entities (collectively referred to herein as the "shareholder defendants").

Shareholder defendants Dillard Munford, Carroll, and Fellows first contend that Munford has standing to assert fraudulent conveyance claims only on behalf of those creditors who were creditors at the time of the Munford LBO and who remained creditors upon the filing of the Chapter 11 petition. These defendants cite First National Bank of Cartersville v. Bayless, 96 Ga. 684 (1895), to support their position that a transfer is not subject to challenge on behalf of subsequent creditors absent actual intent to defraud.

A trustee or debtor in possession may utilize the "strong arm" provision of 11 U.S.C. § 544(b) to avoid a transfer under applicable state law.[15] Therefore, Munford

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[15] This section provides that:

> [t]he trustee [or debtor in possession] may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable

(continued...)

must establish at least one actual, unpaid, and unsecured creditor whose claim existed at the time the Munford LBO occurred. See Dante, supra, 1 B.R. at 548; see also Schaps v. Bally's Park Place, Inc., 58 B.R. 581, 584 (E.D. Pa. 1986); Hadley v. Acquafredda (In re Acquafredda), 26 B.R. 909, 911 (Bankr. M.D. Fla. 1983).

In opposition to defendants' motion, Munford submitted the affidavit of Michael Langford in which he sets forth numerous claims which arose prior to the LBO and remained unpaid on the filing date of the Munford petition. (Affidavit of Michael Langford, ¶ 8). A summary of pre-LBO claimants who filed 47 proofs of claim totaling approximately $7 million is attached as Exhibit 2 to Langford's affidavit. These facts and the existence of these claims are not disputed by any of the defendants.

Defendant Dillard Munford argues, however, that such proofs of claim are not allowed claims. The argument is frivolous. "[A] claim or interest, proof of which is filed under section 501, is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. § 502(a).[16] There is no evidence of any objections to any of these proofs of claim. Moreover, Munford need only establish the existence of

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[15] (...continued)

> under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is allowable only under section 502(e) of this title.

11 U.S.C. § 544(b).

[16] Pursuant to 11 U.S.C. § 1111(a), any claim in the debtor's schedules which is not listed as disputed, contingent, or unliquidated is "deemed filed" without the filing of an actual proof of claim.

one allowable claim. The undisputed evidence establishes numerous such claims.

Further, the shareholder defendants contend that any fraudulent conveyance recovery is limited to the value equal to the amount of the claims asserted by those creditors whose claims existed on the date of the Munford LBO. This contention, likewise, is without merit. Section 544(b), which codifies the Supreme Court's decision in Moore v. Bay, 284 U.S. 4 (1931), allows the entire transfer to be avoidable under applicable state law for the benefit of the entire estate. "Since the recovery is for the benefit of the estate, all creditors holding unsecured claims share in the recovery, not merely those creditors whose rights are asserted." 4 Collier on Bankruptcy, ¶ 544.03 (15th ed. 1989); see also Robinson v. Atlas (In re Hecht), 51 B.R. 72, 76 (Bankr. D. Vt. 1985); Bergquist v. Theisen (In re Theisen), 45 B.R. 122, 126-27 (Bankr. D. Minn. 1984); Dante, supra, 1 B.R. at 548. Therefore, Munford may avoid in toto conveyances determined to be fraudulent and voidable under state law.

Next, the shareholder defendants cite Credit Managers Ass'n of Southern Cal. v. Federal Co., 629 F.Supp. 175 (C.D. Cal. 1985), contending that fraudulent conveyance laws should not be used to recover funds paid to shareholders in a public, arm's length merger transaction. While questioning whether general fraudulent conveyance law is applicable to LBO transactions, the California district court did not rule on the issue because of the parties' failure to brief same. Id. at 179; see Baird & Jackson, Fraudulent Conveyance Law and Its Proper Domain, 38 Vand. L. Rev. 829 (May 1985)). Thus, this case is not helpful.

A majority of courts have concluded that the fraudulent conveyance provisions in the Bankruptcy Code ("Code") or under applicable state law may extend to LBO transactions. See Moody v. Security Pac. Business Credit, Inc., 971 F.2d 1056 (3d Cir. 1992) (the court applied the Pennsylvania constructive fraud provision, adopted from sections 4 and 5 of the Uniform Fraudulent Conveyance Act ("UFCA")); Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635 (3d Cir. 1991) (court applied the constructive fraud provision of § 548(a)(2)); United States v. Tabor Court Realty Corp., 803 F.2d 1288 (3d Cir. 1986); Kendall v. Sorani (In re Richmond Produce Co., Inc.), 151 B.R. 1012 (Bankr. N.D. Cal. 1993); Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.), 100 B.R. 127 (Bankr. D. Mass. 1989); In re Ohio Corrugating Co., 70 B.R. 920 (Bankr. N.D. Ohio 1987). Other courts, while recognizing that general fraudulent conveyance provisions apply to LBOs, have insulated selling shareholders with no knowledge of the LBO transaction from fraudulent conveyance liability. See Lippi v. City Bank, 955 F.2d 599 (9th Cir. 1992); Kupetz v. Wolf, 845 F.2d 842 (9th Cir. 1988); Weiboldt Stores, Inc. v. Schottenstein, 94 B.R. 488 (N.D. Ill. 1988) ("Weiboldt I"). This court agrees with the majority view and concludes that fraudulent conveyance laws may extend to LBO transactions.

A. Avoidability of fraudulent conveyances under Georgia law

Munford seeks to avoid payments made to the shareholder defendants under 11 U.S.C. § 544(b) and the Georgia constructive fraud provision of O.C.G.A. § 18-2-

22(3). The Georgia statute provides in pertinent part that:

> [t]he following acts by debtors shall be fraudulent in law against creditors and as to them shall be null and void: . . .
>
> > (3) Every voluntary deed or conveyance, not for a valuable consideration, made by a debtor who is insolvent at the time of the conveyance.

O.C.G.A. § 18-2-22(3). To establish a fraudulent conveyance under this statute, Munford must establish three elements as follows: (1) a conveyance by Munford of its property to the shareholder defendants; (2) the conveyance was voluntary and not for a valuable consideration; and (3) Munford was insolvent or rendered insolvent at the time of the conveyance. See Brown v. Citizens & Southern National Bank, 253 Ga. 119, 122, 317 S.E.2d 180 (1984); Leachman v. Cobb Dev. Co., 226 Ga. 103, 104, 172 S.E.2d 688 (1970).

Insolvency. First, all parties agree that there is a genuine issue of material fact with regard to whether Munford was rendered insolvent at the time of the LBO transaction. Munford conceded in oral argument that it was not insolvent immediately prior to the LBO but contends it was rendered insolvent by the LBO transaction. The shareholder defendants contend, however, that summary judgment is appropriate because Munford cannot prove either the first or second requirement.

Conveyance of Munford Property. The facts are not disputed as to the source of the funds used to pay Munford shareholders. Munford transferred $61,811,235 from its C&S account #00168005 to Citizens & Southern

Trust, the Exchange Agent. (Deposition Exhibit 378). These funds were used to pay the shareholders for their shares at $17 per share. While Munford was not the entity which undertook to purchase these shares, the evidence clearly establishes that the funds transferred to the Exchange Agent were property of Munford.

Voluntary Conveyance-Valuable Consideration. Next, the shareholder defendants contend that the Munford LBO was not "voluntary" because Munford received "valuable consideration" in exchange for the payments made to them as part of an arm's length, legitimate business transaction. In Georgia, a "voluntary conveyance" is defined as a transfer "without consideration." Brown, 253 Ga at 122. "A valuable consideration is founded on money, or something convertible into money, or having a value in money." Stokes v. McRae, 247 Ga. 658, 659, 278 S.E.2d 393 (1981).[17] "Great inadequacy of consideration in the transfer of property creates strong inferences that the transfer was fraudulent." United States v. McMahan, 392 F.Supp. 1159, 1166 (N.D. Ga. 1975), aff'd, United States v. McMahan, 556 F.2d 362 (5th Cir. 1977), rev'd in part on other grounds, United States v.

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[17] In contrast, pursuant to 11 U.S.C. § 548(a)(2), a trustee or debtor in possession is allowed to avoid a transfer made by the debtor within one year of the filing of the bankruptcy petition, where the debtor received "less than a reasonably equivalent value" and became insolvent as a result of the transfer. Because Munford filed for bankruptcy more than one year after the LBO transaction, the constructive fraud provision of § 548 is not available to Munford.

McMahan, 569 F.2d 889 (5th Cir. 1978).[18] Georgia law does not provide, however, for avoidance of a transfer merely for "less than equivalent value" if in fact a valuable consideration was received.

The shareholder defendants contend that Munford received "valuable consideration" in connection with the LBO as follows: (1) $550,000 in cash; (2) payment of a $20 million debt to Aetna Life and Casualty Co. ("Aetna"); (3) a line of credit with unused availability; (4) new management; (5) Munford stock worth approximately $5 million; and (6) a federal income tax benefit of approximately $5.4 million as a result of the sale of World Bazaar.

At closing, Munford received $550,000 in the merger with AMC. However, Munford simultaneously paid $550,000 as a fee to Winter Park Capital, an affiliate of AAC. (Deposition Exhibit No. 378). Munford never had dominion over or received any benefit from these funds. This appears to be merely a pass-through of funds. By merger $550,000 came in and by simultaneous wire transfer $550,000 went out. A jury could find that Munford was merely a "conduit" for the $550,000 payment. The court concludes, therefore, that there is a genuine issue of material fact regarding whether the $550,000 received in the merger with AMC constitutes "valuable consideration."

Munford concedes that a $20 million note payable to Aetna Life and Casualty Company ("Aetna") was paid,

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[18] See Bonner v. City of Prichard, 661 F.2d 1206, 1207 (11th Cir. 1981) (decisions rendered by former Fifth Circuit prior to October 1, 1981, adopted as precedent by the Eleventh Circuit).

including a pre-payment penalty of over $2 million. However, Munford entered into a new debt based upon the Citicorp financing of $54.8 million.[19] At the time, Munford was under no obligation or compulsion to pay off the Aetna note. In fact, Munford was current on all of its existing debt with approximately $14 million in cash reserves. It appears that the Aetna and other debt was paid to clear title to Munford's assets pledged as security to Citicorp, even though the Aetna payoff resulted in a $2 million penalty.

Further, the new Citicorp indebtedness was at higher interest rates that those of the old debt. Munford's debt to equity ratio was .26 to 1.0 immediately before the LBO transaction and 9.0 to 1.0 immediately after the Munford LBO. (Deposition Exhibit No. 429, Exhibit 7(I)). Thus, Munford's financial condition actually diminished as a result of this more onerous and burdensome new debt. A jury could find that the pay off of Aetna, and other old debt, was not a valuable consideration or that it was grossly inadequate consideration for the LBO. As such, there are genuine issues of material fact regarding whether or not Munford received "valuable consideration" by paying off the old debt.

Defendants contend that Munford received a revolving line of credit, access to which served as "valuable consideration." Citicorp's financing commitment provided for a $54.8 million revolving credit loan facility in favor of Munford. However, Munford's access to a revolving line

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[19] Munford also guaranteed the Citicorp loans to World Bazaar of approximately $17 million, although the World Bazaar sale was not required by the Merger Agreement. This brought the total new debt to $71.8 million.

of credit is not a contribution of any measurable monetary value. Even if there is some value, it would appear to be grossly inadequate consideration for the obligations incurred.

The shareholder defendants further contend that the acquisition of new management constitutes "valuable consideration" sufficient to support the Munford LBO. In support, the shareholder defendants cite C-T of Virginia, Inc. v. Euroshoe Assoc. Ltd. Partnership, 762 F.Supp. 675 (W.D. Va. 1991), aff'd, C-T of Virginia, Inc. v. Euroshoe Assoc. Ltd. Partnership, 953 F.2d 637 (4th Cir. 1992) (Table).

In C-T, an LBO merger was structured in a similar manner to the one in the present case. C-T filed suit against 45 of its shareholders seeking to void the transfers to them as fraudulent conveyances. In rejecting C-T's fraudulent conveyance claim and granting summary judgment in favor of the former shareholders, the court concluded that C-T received valuable consideration at law which included an investment of "new capital of $4 million" and new management. C-T, 762 F.Supp. 678. This case is distinguishable on its facts. In the Munford LBO, a jury could find that there was no new capital or that any new capital received was grossly inadequate.

Further, assuming that new management was to be provided, it is virtually immeasurable and of relatively negligible value to the corporation. As such, new management does not favorably affect or add to the net worth of the corporation. Even if worth something, such ephemeral benefits do not constitute valuable consideration. See Richmond Produce, supra, 151 B.R. at 1018; see also Moody v. Security Pac. Business Credit, Inc.,

127 B.R. 958, 993 (W.D. Pa. 1991), aff'd, Moody v. Security Pac. Business Credit, Inc., 971 F.2d 1056 (3d Cir. 1992).

Even if new management could constitute "valuable consideration," there is conflicting evidence as to whether new management served as consideration in connection with the Munford LBO. Defendant Andrall Pearson testified that one of the motives for the LBO was to provide Munford with new management. It is undisputed that Joseph Leonardo was chosen to run post-acquisition Munford. In fact, Leonardo was employed and began to operate Munford in the late summer of 1988, prior to the closing of the LBO. However, in a letter dated September 26, 1988, Dillard Munford advised Munford's directors that Leonardo had agreed to run Munford's convenience stores even if the Munford LBO did not close. When questioned about continued employment, Leonardo testified that he did not commit one way or the other. This conflicting evidence establishes a factual dispute from which a jury could conclude that new management was not a valuable consideration for the LBO or that it was grossly inadequate.

Next, the shareholder defendants contend that Munford received stock worth $5 million. At the time of its merger into Munford, AMC owned 291,177 shares of Munford stock. The Merger Agreement provides that:

> Section 3.1 Merger Price. As of the Effective Date, by virtue of the Merger and without any action on the part of any holder of the [Munford] $1.00 par value common stock or on the part of [AAC] with regarding to [AMC's] common stock:
>
> (a) All shares of the [Munford] Common Stock held as treasury shares by [Munford] or by any

> wholly owned subsidiary of [Munford] and all shares of the [Munford] Common Stock held by [AAC] or [AMC] shall be cancelled and retired and no consideration shall be exchanged for such shares;
>
> (b) Except as otherwise provided in Section 3.1(a), each share of [Munford] Common Stock issued and outstanding immediately prior to the Effective Date shall be converted into the right to receive a cash payment in an amount equal to Seventeen Dollars ($17.00) (the "Merger Price") [.] (emphasis supplied).

While this section automatically converted Munford shares to the right to receive a cash payment of $17 per share, the AMC shares were cancelled and retired for no consideration. Thus, no funds were paid or to be paid for the AMC shares of Munford.

Most courts have found that the acquisition or redemption by a corporation of its own shares gives nothing of value to the corporation. See Consove v. Cohen (In re Roco Corp.), 701 F.2d 978, 982 (1st Cir. 1983); Corporate Jet Aviation, Inc. v. Vantress (In re Corporate Jet Aviation, Inc.), 57 B.R. 195 (Bankr. N.D. Ga. 1986), aff'd, In re Corporate Jet Aviation, Inc., 82 B.R. 619 (N.D. Ga. 1987); Louisiana Industrial Coatings, Inc. v. Pertuit (In re Louisiana Coatings, Inc.), 31 B.R. 688, 698 (Bankr. E.D. La. 1983); Flanigan v. De Feo (In re De Feo Fruit Co., Inc.), 24 B.R. 220, 225 (Bankr. W.D. Mo. 1982); but see Day v. Central Fidelity Bank, N.A. (In re Appomattox Agri-Service, Inc.), 6 B.C.D. 1239 (Bankr. W.D. Va. 1980). Such returned shares are not assets and do not add any value or enhancement to the corporation. In the present case, rather than redeeming the AMC shares in exchange for cash consideration, they were cancellation

and retired for no cash consideration. A jury could find that such cancellation provided Munford with no consideration or grossly inadequate consideration for the LBO.

Finally, the shareholder defendants contend that Munford received "valuable consideration" in the form of a federal income tax benefit of approximately $5.4 million resulting from a capital loss of $16 million in the World Bazaar sale. This resulting tax benefit, however, was an incident of the asset sale and was not a contribution of capital to Munford.

A jury considering the facts in this case could conclude that, in the context of a $90 million LBO, the various items alleged were not a valuable consideration for the LBO or that they were grossly inadequate consideration. Accordingly, summary judgment in favor of the shareholder defendants should be denied on this issue because genuine issues of material fact exist regarding whether Munford received "valuable consideration" in connection with the Munford LBO.

B. "Initial transferee" under 11 U.S.C. § 550

If the Munford LBO is avoidable under § 544(b), section 550(a) would permit Munford to recover said transfer from the following:

> (1) the initial transferee of such transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. § 550(a). The shareholder defendants contend that they were not the "initial transferee" of funds re-

ceived in exchange for their shares because Citicorp's financing never became property of Munford. The shareholder defendants assert that AAC was the "initial transferee" since the funds from Munford's account were first transferred to Citizens & Southern Trust, an account allegedly controlled by AAC. The determination of whether AAC or Citizens & Southern Trust was a "transferee" in this transaction depends on whether they exercised dominion and control over the funds in the Exchange Agent account or served as mere conduits in the transaction. See Nordberg v. Societe Generale (In re Chase & Sanborn Corp.), 848 F.2d 1196, 1200 (11th Cir. 1988); Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988). The conduit issue is equitable in nature which under Eleventh Circuit precedent requires courts to consider "the entire circumstance" of the transaction. Chase & Sanborn, 848 F.2d at 1199.

As noted herein, Munford transferred $61,811,235 from its account at C&S to the Exchange Agent, Citizens & Southern Trust. These funds were used to purchase the outstanding common stock of Munford at $17 per share. There is no evidence that AAC had control or dominion over the funds in the Citizens & Southern Trust account. In fact, the Merger Agreement expressly required AAC and Munford to give Citizens & Southern Trust ". . . irrevocable written instructions to make the cash payments provided for in Section 3.2(a) . . . ." (Deposition Exhibit No. 1, Merger Agreement, section 3.2(b)). Further, the funds could only be used for the purpose specified in the Merger Agreement. Therefore, Citizens & Southern Trust merely served as a depository and disbursing agent of the funds received from Munford and disbursed to its former shareholders. Citizens & South-

ern Trust and other financial institutions through which the funds passed are "mere conduits" with regard to the Munford LBO. The court concludes that the shareholder defendants are "initial transferees" under § 550(a) and that summary judgment in favor of the shareholder defendants on this issue should be denied. In view of this conclusion, the issues raised under § 550(b) are rendered moot.

C. "Settlement payment" pursuant to 11 U.S.C. § 546(e)

The shareholder defendants assert that the payments received by them in the Munford LBO constitute a "settlement payment" pursuant to § 546(e) and may not be avoided by Munford. The undisputed facts establish that Munford shares owned by DFA Entities were tendered to the paying agent, Citizens & Southern Trust, in exchange for cash in the following manner:

> DFA Entities' stock certificates for Munford were held by the Depository Trust Company ("DTC"). On December 2, 1988, Morgan Guaranty, in its role as custodian, directed the DTC to surrender the shares of Munford held by DFA Entities to receive payment of $17 per share. By electronic or physical transfer, the DTC tendered the Munford shares to Citizens & Southern Trust. That is, the DTC debited the stocks from its records and issued a credit to Citizens & Southern Trust. Simultaneously, Citizens & Southern Trust credited the DTC with the cash value of the shares tendered. After the cash value of the Munford shares was credited to the DTC, the DTC deposited the funds in an account held by Morgan Guaranty. Upon receipt of the Funds, Morgan

> Guaranty credited the amounts received to the appropriate DFA Entities' accounts.

Likewise, the other shareholder defendants, except Gardiner, tendered their shares directly to Citizens & Southern Trust to receive the cash consideration. (See Affidavit of Neal Berinhout, ¶ 10, Munford Shareholder List). The record is unclear as to how Gardiner's shares were tendered and the cash consideration paid.

Thus, the question presented is whether § 546(e) prohibits avoidance of these payments. It appears that only two courts have considered whether payments to beneficial shareholders in an LBO are "settlement payments," and they reached opposite conclusions. See Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.), 952 F.2d 1230 (10th Cir. 1991) ("Kaiser II"); Weiboldt Stores, Inc. v. Schottenstein, 131 B.R. 655 (N.D. Ill. 1991) ("Weiboldt II"). Consequently, this court is confronted with conflicting decisions on an issue that appears to be one of first impression in this circuit.

In Weiboldt II, an Illinois district court examined an LBO transaction involving a tender offer in which WSI Acquisition Corporation ("WSI") acquired Weiboldt Stores, Inc. ("Weiboldt"). Weiboldt II, 131 B.R. at 663. Harris Trust and Savings Bank ("Harris Bank") was appointed by WSI to act as depository and disbursing agent for its acquisition of all of the issued and outstanding shares of Weiboldt at $13.50 per share. Under WSI's tender offer, Weilboldt's shareholders were instructed to tender their shares to Harris Bank who was then required:

> to disburse the payments to the tendering shareholders upon its receipt "of certificates for such shares, or a timely confirmation of a book entry

> transfer of such shares into the Depositary's account at the [DTC], the Midwest Securities Transfer Company . . . or [t]he Pacific Securities Depository Trust Company . . . ."

Id.

That court found that the language of § 546(e) was not dispositive, and the definition of "settlement payment" was "circular" and cryptic. Weiboldt II, 131 B.R. at 663. The court held that:

> [a] review of the legislative history of [§] 546(e) reveals that Congress exempted settlement payments in the commodities (and later the securities) industry out of concern that the bankruptcy of one party in the clearance and settlement chain could spread to other parties in that chain . . . .
>
> . . . [R]equiring the [Weiboldt shareholders] to return to the [t]rustee payments they received from WSI through Harris Bank poses no threat to those in the clearance and settlement chain.

Id. at 664 (footnotes and citations omitted). Based on its examination of the legislative history, the court concluded that § 546(e) did not bar the trustee's claims against the Weiboldt shareholders. Id. at 665.

Subsequently, in Kaiser II, the Tenth Circuit considered this issue. Kaiser II, 952 F.2d at 1235. Pursuant to a plan of merger, Kaiser Steel Corporation ("Kaiser Steel") merged with a new entity formed by a group of outside investors, with Kaiser Steel emerging as the surviving entity. Each outstanding share of Kaiser Steel common stock was then exchanged for $22 and two shares of preferred stock. The Kaiser II court concluded that the term "settlement payment" was "extremely

broad," that the LBO payments made to the beneficial Kaiser Steel shareholders were within its scope, and that such payments were protected from avoidance under § 546 (e).[20] Id. at 1237-41.

The parties have not cited, and the court has not found, any other cases which have addressed this precise issue.[21] In considering whether the payments to the shareholder defendants are protected from avoidance, the

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[20] Prior to Kaiser II, the Tenth Circuit considered whether payments made to financial intermediaries, such as a stockbroker, in connection with an LBO transaction are protected "settlement payments" as defined in § 741(8). Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990) ("Kaiser I"). The Tenth Circuit noted that the language was "somewhat circular" but concluded that such payments are "settlement payments" and that § 546(e) protected them from avoidance. Id. at 848-50.

[21] However, of the several commentators who have addressed this conflict, the majority have disagreed with the Kaiser analysis. See Neil M. Garfinkel, Note, No Way Out: Section 546(e) Is No Escape For The Public Shareholder Of A Failed LBO, 1991 Colum. Bus. L. Rev. 51 (1991); Gerald K. Smith and Frank R. Kennedy, Fraudulent Transfers and Obligations: Issues of Current Interest, 43 South Carolina L. Rev. 709 (1992); William C. Rand, In re Kaiser Steel Corporation: Does Section 546(e) Of The Bankruptcy Code Apply To A Fraudulent Conveyance Made In The Form Of An LBO Payment?, 19 Fordham Urb. L. J. 87 (1991); Jane Elizabeth Kiker, Judicial Repeal Of Fraudulent Conveyance Laws: Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990), 14 Hamline L. Rev. 453 (1991); but see Michael Cook, Brad J. Axelrod, and Geoffrey S. Frankel, The Judicially Created "Innocent Shareholder" Defense To Constructive Fraudulent Transfer Liability In Failed Leveraged Buyouts, 43 South Carolina L. Rev. 777 (1992). They contend that § 546(e) was not intended to protect such LBO consideration payments form avoidance.

court must determine the meaning and scope of the term "settlement payment" as defined in § 741(8). Statutory construction generally begins with the language of a statute. See Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Sav. & Loan Ass'n, 878 F.2d 742, 749-50 (3d Cir. 1989) (quoting Mansell v. Mansell, 490 U.S. 581 (1989)). Nevertheless, in construing a particular statute, a court is "'not . . . guided by a single sentence or member of a sentence, but [should] look to the provisions of the whole law, and to its object and policy.'" Bevill, 878 F.2d at 750 (quoting Massachusetts v. Morash, 490 U.S. 107, 115 (1989)). Further, as instructed by the Eleventh Circuit, "[i]t is especially important to consider the goal of a law, and the effect of a particular ruling, in areas of law as bankruptcy jurisdiction that are so strongly rooted in equitable principles." Chase & Sanborn, supra, 848 F.2d at 1202; see also Bank of Marin v. England, 385 U.S. 99, 103 (1966).

Section 546(e) provides in pertinent part that:

> . . . the trustee may not avoid a transfer that is a margin payment, as defined in section 101(34) [sic (38)], 741(5), or 761(15) of this title, or settlement payment, as defined in section 101(35) [sic (39)] or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of this case, except under section 548(a)(1) of this title.

11 U.S.C. § 546(e). The term "settlement payment" is defined in § 741(8), as a

> preliminary settlement payment, a partial settlement payment, an interim settlement payment,

> a settlement payment on account, a final settlement account, or any other similar payment commonly used in the securities trade."[22]

11 U.S.C. § 741 (8).

This court agrees with the several courts that have found the definition of "settlement payment" to be circular or facially ambiguous. See Bevill, 878 F.2d at 751; Kaiser I, 913 F.2d at 848; Weiboldt II, 131 B.R. at 663.[23] To ascertain the meaning and scope of the term as used in §§ 546 (e) and 741(8), it becomes necessary therefore to analyze the legislative history. See Blum v. Stenson, 465 U.S. 886, 896 (1984); Bevill, 878 F.2d at 751; Weiboldt II, 131 B.R. at 663.

At the outset, the court is confronted with two conflicting legislative policies. The court must either harmonize these policies or determine which policy Congress intended to prevail. On the one hand, the Code grants trustees broad power to avoid fraudulent transfers. Such power serves to protect the interests of creditors by permitting recovery of assets transferred by means of actual or constructive fraud. On the other hand, when Congress amended the Code in 1982, it expressed a policy in § 546(e) to limit the trustee's power to avoid a transfer that is a margin or settlement payment except

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[22] Section 101(39) also provides a definition for "settlement payment" which applies only to forward contracts. See 11 U.S.C. § 101(39).

[23] But see Kaiser II, 952, F.2d at 1237 (the Kaiser II court appears to have ignored its earlier finding in Kaiser I that the definition of "settlement payment" in § 741(8) is "somewhat circular" in concluding that the statute should be applied based on its plain meaning); Jonas v. Resolution Trust Corp. (In re Comark), 971 F.2d 322, 325 (9th Cir. 1992).

in cases of actual fraud. See H.R. Rep. No. 420, 97th Cong., 2d Sess. 2 (1982), reprinted in 1982 U.S. Code Cong. & Admin. News, p. 583 ("1982 House Report").

The legislative history of former § 764(c) indicates that Congress' intent was to insulate ". . . margin payments and other deposits from the avoiding powers except to the extent of actual fraud. This facilitates prepetition transfers and protects the ordinary course of business." H.R. Rep. No. 595, 95th Cong., 2d Sess. 92 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News, p. 6348 (emphasis supplied). Likewise, the 1982 amendments were intended "to clarify and in some [but not all] instances, broaden the commodities market protections and expressly extend similar protections to the securities market." 1982 House Report at 583 and 587 (emphasis supplied). Section 546(e) replaced and incorporated the provisions of former § 764(c). As part of its clarifying changes, Congress enacted § 741(5) and (8) to define "margin payment" and "settlement payment," respectively. It is reasonable to conclude, therefore, that Congress intended § 546(e) to extend the same "ordinary course of business" protections accorded the commodities industry to the securities industry. See 4 Collier on Bankruptcy, ¶ 546.05 (15th ed. 1990).[24]

The parties have cited no securities industry definitions of "settlement payment" other than those considered by the Bevill and Kaiser courts. From the court's

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[24] But see Kaiser I, 913, F.2d at 849. The Tenth Circuit concluded that the 1982 amendments expanded the market protections "beyond the ordinary course of business to include margin and settlement payments to and from brokers, clearing organizations, and financial institutions." Id.

review of these definitions, it is apparent that they contemplate securities transactions "in the ordinary course of business" in the securities market. The various securities industry definitions generally refer to the completion of a securities transaction or group or transactions. See Kaiser II, 952 F.2d at 1238; Kaiser I, 913 F.2d at 849.

None of these definitions expressly apply the term "settlement" or "settlement payment" to payments made in connection with the mandatory tendering or redemption of stock in an LBO transaction. Even in Kaiser I and Kaiser II, the Tenth Circuit recognized that an LBO transaction is not a routine securities' transaction. Further, such transaction is not one which occurs in the ordinary course of business of a stockbroker or any other participant in the clearance and settlement chain. These definitions, therefore are consistent with the "ordinary course of business" limitation of former § 764(c) as incorporated into § 546 (e). The legislative history clearly indicates that both former § 764(c) and § 546(e) were intended to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly resulting in the collapse of the affected market. See 1982 House Report at 583-84. This court is of the view that the Kaiser II court painted with too broad a brush. In that case, the court itself recognized that such conclusion was "not without merit" and that its holding was "broad in its application." See Kaiser II, 952 F.2d at 1239, 1241 (quoting Kaiser I, 913 F.2d at 850). The court concludes, therefore, that § 546(e) was intended to protect from avoidance ordinary course of business transactions by participants in the clearance and settlement chain of the commodities and securities market.

In the present case, the Munford LBO undoubtedly was a securities transaction. The former shareholders effectively sold their equity interest in Munford in exchange for cash consideration. In settlement of the transaction, they tendered their shares and received payments. Nevertheless, this was essentially a private transaction between Munford and its shareholders. The public market for buying and selling securities was not meaningfully implicated. The clearance and settlement system was involved only to the extent that DFA Entities used financial intermediaries to hold its Munford stock. In that instance, the system was merely used as a convenient conduit to surrender their shares and obtain payment of the LBO consideration. The clearance and settlement system was bypassed altogether by the other shareholder defendants since they tendered their shares directly to Citizens & Southern Trust. Although Citizens & Southern Trust is a financial institution, it was not acting in this LBO transaction as a participant in the clearance and settlement system as contemplated by § 546(e). Permitting recovery from the shareholder defendants will not threaten the system or any of the institutions within the clearance and settlement chain. See Weiboldt II, 131 B.R. at 664-65.

Moreover, there is no manifest Congressional intention to protect LBO consideration payments from avoidance. In contrast, Congress has expressly manifested an intent to protect payments made in connection with repurchase agreements by enacting § 546(f). Both the Third Circuit and the Ninth Circuit have concluded that the transfer of securities in connection with a repurchase agreement are protected "settlement payments." See Jonas v. Reso-

lution Trust Corp., (In re Comark), 971 F.2d 322, 325 (9th Cir. 1992); Bevill, 878 F.2d at 743.

In Comark, the Ninth Circuit applied § 546(e) and the definition of "settlement payment" in § 741(8) to the "repo transaction." Comark, 971 F.2d at 325. The court notes, however, that Comark was decided after § 546(f) was added to the Code but before its effective date. The Bevill court's conclusion was predicated on the term "settlement payment" as presented in § 546(f), not § 546(e). In both cases, the courts examined the repo market and determined that it was a huge market serving several important roles in the nation's economy. Comark, 971 F.2d at 325; Bevill, 878 F.2d at 745. For example, "[t]he repo market is used by the Federal Reserve System to help execute monetary policy, and serves to finance the national debt at the lowest possible cost." Bevill. at 745. As such, repo transactions are ordinary course of business transactions, which fully implicate the clearance and settlement system that Congress intended to protect.

In this court's view, the conflicting legislative policies noted above can be effectively harmonized. Generally, equity shareholder interests are subordinate to creditor interests. See Robinson v. Wangeman, 75 F.2d 756, 757 (5th Cir. 1935). This traditional right of creditors to be paid before shareholders in a bankruptcy case is preserved by the avoidance of fraudulent conveyances. Where the elements of a constructive fraudulent conveyance are satisfied, avoidance of LBO payments to shareholders does not meaningfully conflict with Congress' fundamental intent to protect the participants in the securities clearance and settlement system. Such an interpretation of § 546(e) furthers the goal of protecting

the priority of creditor interests over those of equity security holders where a constructive fraudulent conveyance has occurred. At the same time, "ordinary course of business" security transactions in the public market are protected.

Based on the foregoing reasoning, this court agrees with Weiboldt II and concludes that § 546(e) does not prohibit avoidance of payments made to the shareholder defendants. Therefore, the shareholder defendants are not entitled to summary judgment as a matter of law.

II. Count V

Defendant Dillard Munford entered into an employment contract with Munford which originally provided for termination payments equal to five years of his base salary if he were involuntarily terminated or suffered a substantial decrease in his responsibilities. Similarly, defendants Fellows and Carroll entered into employment contracts with Munford which originally provided for termination payments over a three year period equal to their base salary at the time of termination. Modifications to each of the agreements were approved by the board of directors to provide that the severance provisions would become operative upon the closing of the Munford LBO.[25]

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[25] Under the modified agreements, the final compensation for these officers upon termination was as follow: (1) $1,837,500 to Dillard Munford over a period of five years; (2) $720,000 to Mr. Fellows over a period of three years; and (3) $480,000 to Mr. Carroll over a period of three years. (See Deposition Exhibit No. 1, LBO Proxy Statement, p. 26-27).

Citing International Ins. Co. v. Johns, 874 F.2d 1447 (11th Cir. 1989), the officer defendants contend that "golden parachutes," or severance agreements, must be evaluated under the business judgment rule. This rule protects a board of director's decision regarding severance agreements unless they constitute corporate waste. Id. at 1461. The Eleventh Circuit has instructed that courts should not invalidate a severance agreement so long as the compensation received by the departing officer ". . . bares a reasonable relationship to the services rendered." Id. "Corporate waste exists when the payment is afforded without 'adequate' consideration." Id.

Munford, however, does not assert that the severance payments received by the officer defendants constitute corporate waste in violation of the business judgment rule. Instead, Munford asserts that such payments to the officer defendants constitute fraudulent conveyances in violation of O.C.G.A. § 18-2-22(3). As noted above, the parties have stipulated that genuine issues of material fact exist regarding whether Munford was rendered insolvent by the LBO transaction.

Nevertheless, the officer defendants assert that summary judgment is appropriate because the severance agreements were supported by "valuable consideration." See Stokes, supra, 247 Ga. at 659. They contend that the modified severance agreements were executed to induce the officer defendants to remain through the consummation of the Munford LBO and that their continued performance constituted "valuable consideration." Munford contends, however, that the purported consideration was a "sham."

All of the parties cite Royal Crown Cos., Inc. v. McMahon, 183 Ga. App. 543, 359 S.E.2d 379 (1987), which analyzed whether a written severance agreement with McMahon was void as being without consideration. The agreement expressly provided certain severance pay and benefits as an inducement for and in consideration of McMahon's continued employment. Id. at 544. The Georgia Supreme Court concluded that such agreement was offered expressly to induce McMahon to remain in his position during merger negotiations and that continued performance under a terminable-at-will contract was sufficient consideration. Id. at 545.

The officer defendants' modified severance agreements contain no such language. Nothing in the modifications even suggest that they were to serve as an inducement for continued employment until consummation of the LBO. Further, Dillard Munford testified that he did not need an enhancement package of severance benefits to stay with Munford until closing. (Deposition of Dillard Munford, p. 98). Fellows and Carroll testified that they had no plans to leave prior to the LBO; (Deposition of Russell Fellows, p. 66; Deposition of James Carroll, p. 96-97). Further, Rymer testified that the modifications were based on the past services and the offer of a monetary incentive to stay was never a consideration or concern. (Deposition of S.B. Rymer, Jr., p. 159-160).

A jury considering the evidence could conclude that there was no consideration for the payments received pursuant to the modified severance agreements and that such payments were mere "gifts" without valuable consideration. Thus, the court concludes that genuine issues of material fact exist with regard to whether Munford received "valuable consideration" in exchange for any

payments made pursuant to the modified severance agreements. Accordingly, summary judgment in favor of the officer defendants regarding Count V should be denied.

III. COUNTS II AND IV

In Counts II and IV, Munford asserts that defendants Dillard Munford, Fellows, Carroll, Blount, Dickson, Ferguson, Gardiner, LeBlond, Pearson, and Rymer, Jr. (collectively the "officer and director defendants"), breached their fiduciary duty to Munford and negligently mismanaged and wasted its assets. The officer and directory defendants cite Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co., 417 U.S. 703 (1974), to support their contention that Munford is estopped from pursuing these claims.

In that case, the complaining shareholder acquired the majority of its shares well after the alleged wrongs were said to occur. That case is factually distinguishable from the present case. Here, all allegations of mismanagement and breach of fiduciary duties are based on the actions of the officer and director defendants in connection with the Munford LBO and their effects on the corporation. The equitable principals enunciated in Bangor Punta neither apply nor preclude Munford from prosecuting its claims against the officer and director defendants on behalf of its creditors and its estate. See Weiboldt I, supra, 94 B.R. at 507-09.[26]

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[26] In Weiboldt I, which involved an LBO transaction, the Illinois district court found that such principals enunciated in

(continued...)

Next, Munford contends that these defendants breached their duties in approving and effecting the Munford LBO by failing to consider the interests of any corporate constituents other than the former shareholders. The officer and director defendants contend, however, that their only obligation under the circumstances was to "maximize shareholder value." They further contend that their decisions and actions with regard to the Munford LBO are protected under the business judgment rule.

Generally, the business judgment rule creates ". . . a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). Under Georgia law, a director must discharge his duties in good faith and with the care of an ordinary and prudent person under similar circumstances. O.C.G.A. § 14-2-152.1(a)(1) (1982).[27]

> In discharging his duties, a director is entitled to rely on information, opinions, reports, or statements, including financial statements and other

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[26] (...continued)
Bangor Punta precluded Weiboldt from pursuing its claims against the directors on behalf of itself. Weiboldt I, 94 B.R. at 508. The court concluded, however, that such action could be maintained on behalf of its creditors who suffered a direct injury as a result of the directors' wrongdoing. Id.

[27] Although O.C.G.A. § 14-2-152.1 was superseded by O.C.G.A. § 14-2-830 on July 1, 1989, the former provision was in effect at all times relevant herein and is controlling authority in this action.

> financial data, if prepared or presented by: (B) . . . public accountants, investment bankers, or other persons as to matters the director reasonably believes are within the person's professional or expert competence . . . .

O.C.G.A. § 14-2-152.1(a)(2) (1982). The business judgment rule protects directors unless there has been a clear showing of ". . . fraud, bad faith or abuse of discretion." Cottle v. Storer Communication, Inc., 849 F.2d 570, 575 (11th Cir. 1988).

"It is settled law that corporate officers and directors occupy a fiduciary relationship to the corporation and its shareholders, and are held to the standard of utmost good faith and loyalty." Quinn, supra, 254 Ga. at 217 (citing King Mfg. Co. v. Clay, 216 Ga. 581, 118 S.E.2d 581 (1961)). Munford argues that the officer and director defendants owed an obligation or duty to creditors in connection with the Munford LBO. In McEwen v. Kelly, 140 Ga. 720, 79 S.E. 777 (1911), the Georgia Supreme Court stated that:

> [i]n a solvent, going concern, directors are the agents or fiduciaries of the corporation, not of its creditors. But directors are not wholly without duties to creditors. They can not [sic] misappropriate the corporate assets, or give them away, so that creditors are prevented from collecting their debts; and under some circumstances a trust or quasi trust relationship exists toward creditors.

Id. at 724. All parties acknowledge that officers and directors owe a duty to creditors after a corporation becomes insolvent. See Fountain v. Burke, 160 Ga. App. 262, 263-64, 287 S.E. 2d 39 (1981); Ware v. Rankin, 97 Ga. App. 837, 838-39, 104 S.E.2d 555 (1958).

In 1985, the Delaware Supreme Court in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), considered the responsibilities and duties of directors under the business judgment rule in the context of a takeover bid. In Unocal, a group of shareholders ("Mesa"), which held approximately 13% of Unocal Corp's ("Unocal") stock, commenced a hostile tender offer to acquire the majority of the company's stock at a price of $54 per share. Unocal's board of directors rejected Mesa's tender offer and approved an exchange offer to combat Mesa's takeover bid. This exchange offer provided that once Mesa acquired the requisite majority of shares, Unocal would buy the remaining 49% of outstanding shares ". . . for an exchange of debt securities having an aggregate par value of $72 per share." Id. at 951. Mesa was excluded from participating in Unocal's exchange offer. The court concluded that Unocal's board of directors should consider:

> . . . the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the qualities of securities being offered in the exchange.

Id. at 955 (emphasis supplied).

It is undisputed that following the Unocal decision, Munford amended its Articles of Incorporation on August 7, 1986, to include Unocal anti-takeover language in Article IX as follows:

> [t]he board of directors of the corporation, when evaluating any offer of another person to make a tender or exchange offer for the Common Stock of the corporation, to merge or consolidate the corporation with another person, or to purchase or otherwise acquire all or substantially all of the properties and assets of the corporation, shall, in determining what is in the best interests of the corporation and its stockholders, give due consideration to all relevant factors, including without limitation . . . (i) the social, legal and economic effects of the transaction on the employees, customers and other constituents of the corporation and its subsidiaries; [and] (j) the effects and impact of the proposed transaction on the communities in which the corporation and its subsidiaries operate or are located[.]

(Deposition Exhibit No. 481, Articles of Incorporation, No. 9) (emphasis supplied). Thus, this provision expressly requires consideration of factors similar to those expressed in Unocal.[28]

The officer and director defendants contend, however, that consideration of corporate constituencies was discretionary, unnecessary, and inappropriate. They cite Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), to support the contention that their only obligation was to "maximize shareholder value." In

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[28] The court notes that in 1989, the Georgia legislature amended the corporate code by enacting O.C.G.A. § 14-2-202(b)(5). This subsection authorized such a provision in the articles of incorporation as a grant of discretionary authority to directors. This subsection is not controlling in the present case as it did not become effective until July 1, 1989, well after the consummation of the Munford LBO.

that case, a hostile tender offer was commenced by Pantry Pride, Inc. ("Pantry Pride") to acquire Revlon, Inc. ("Revlon"). Revlon's board of director's rejected this offer and adopted defensive measures to combat the takeover. Pantry Pride responded by continually raising or otherwise enhancing its bid. Finally, Revlon's board of directors authorized management to negotiate with other parties interested in acquiring Revlon. An agreement was negotiated by which Forstmann Little & Co. ("Forstmann") would acquire Revlon through an LBO for $57.25 per share with a lock-up option to purchase certain divisions of Revlon at a price considerably below market value if another acquire obtained 40% of Revlon's shares. Id. at 178. The Delaware Supreme Court concluded that the Revlon directors' instruction to management was a recognition that a sale was inevitable. Id. at 182. Consequently, the directors' fiduciary duty became limited to obtaining the highest price possible for the shareholders. Id. The court reasoned that the ". . . auction-ending lock up agreement with Forstmann" was based on impermissible considerations of corporate constituencies at the expense of Revlon's shareholders. Id.

Revlon, however, is distinguishable from the present case in that there was no allegation or showing that Revlon was rendered insolvent after the purchase by Forstmann. As stated above, there are genuine issues of material fact regarding whether Munford was rendered insolvent by the LBO transaction. Further, no evidence has been presented to suggest or establish that the sale of Munford was inevitable at any time before consummation on November 29, 1988. There was no auction-ending agreement.

Article IX of Munford's articles of incorporation provides that the board of directors "shall" give due consideration to all of the factors listed therein. Generally, Georgia courts have found the word "shall" to be a "word of command" or of a "mandatory nature." See Jones v. Douglas County, 262 Ga. 317 323, 418 S.E.2d 19 (1992); Department of Medical Assistance v. Llewellyn, 197 Ga. App. 231, 398 S.E.2d 256 (1990). The use of the word "shall" in Article IX is a mandatory command that the directors consider ". . . the social, legal and economic effects of the transaction on the employees, customers and other constituents of the corporation and its subsidiaries." The officer and director defendants contend that since Article IX did not specifically list "creditors," they did not owe creditors any duty. Common sense suggests that "creditors," who generally are entitled to payment before shareholders, was one of the "other constituents" to be considered by Munford's directors. While "constituencies" is not defined, this court agrees with Unocal that "other constituents" include creditors, employees, customers, etc.

Further, the testimony concerning the issue is inconsistent and contradictory. Counsel, James Rubright, testified that the board of directors was advised to consider these factors and it did so. Yet, Dillard Munford testified that "constituents" was not a term with any meaning to him. His testimony indicates that no consideration was given to any "constituents" much less creditors of Munford or the affected communities. Likewise, Rymer and Fellows testified that they did not recall the directors considering the economic effect of the Munford LBO on customers or "other constituencies."

At a minimum, the evidence establishes a question of fact as to whether the officer and director defendants considered all of the factors listed in Article IX. A jury considering this evidence could find that the officer and director defendants either abused their discretion or acted in bad faith in violation of Article IX and the business judgment rule. See Cottle, supra, 849 F.2d at 575. Therefore, the court concludes that there are genuine issues of material fact as to whether the officer and director defendants breached their fiduciary duty to Munford and negligently mismanaged and wasted its assets. The officer and director defendants' motion for summary judgment as to Counts II and IV should be denied.

IV. Count III

Munford asserts in Count III that by approving the Merger Agreement, the director defendants violated certain legal restrictions on corporate distributions and share repurchases. Georgia law, in effect at the time of the Munford LBO, provided that "[t]he board of directors of a corporation may . . . distribute to its shareholders out of capital surplus of the corporation a portion of its assets . . ." O.C.G.A. § 14-2-91(a)(1982). However, "[n]o such distribution shall be made at a time when the corporation is insolvent or when such distribution would render the corporation insolvent." O.C.G.A. § 14-2-91(a)(1)(1982).

Likewise, a corporation could not repurchase its own shares if the corporation was insolvent or if the purchase would render the corporation insolvent. O.C.G.A. § 14-2-

92(e) (1982).[29] Directors who voted for or assented to a corporate distribution or stock repurchase in violation of these provisions are jointly and severally liable to the corporation for the amount distributed or the consideration paid to the extent that it violated the restrictions. See O.C.G.A. § 14-2-154(a)(1) & (2) (1982).

The director defendants assert that Georgia's distribution and share repurchase statues do not apply to the Munford LBO. They contend that at the time the Munford LBO consideration payments were made, the recipients were no longer shareholders. In analyzing this transaction, however, the court looks to its substance and not the form. While these defendants were not directors at the time of actual payment, they were directors who approved or assented to the underlying Merger Agreement which structured and required payment to the shareholders.

It is undisputed that the director defendants approved the Merger Agreement which expressly provided for the purchase of the outstanding shares of Munford at $17 per share. The Merger Agreement also contemplated that the funds to be paid to the shareholders would be obtained largely by the pledge of virtually all of Munford's assets as collateral for the Citicorp loan. The source, purpose, and use of Munford's funds were known or should have been known by the director defendants prior to or at the time of the execution of the Merger Agree-

---

[29] O.C.G.A. §§ 14-2-91 & 14-2-92(e) were superseded by O.C.G.A. § 14-2-640 on July 1, 1989. This new section imposes virtually identical limitations on distributions and share repurchases as the provisions in effect when the Munford LBO occurred.

ment and prior to its consummation. The basic means for funding the LBO were set forth in Munford's LBO Proxy Statement. Thus, defendants' approval of the LBO with knowledge of the means of financing and the probable effect upon Munford was a participation in the LBO.

The undisputed evidence shows that the Munford LBO was an integrated transaction with several steps occurring simultaneously. For example, simultaneously at closing, AMC was merged into Munford, the director defendants resigned, the Citicorp loans were made and funds borrowed, Munford funds were transferred to Citizens & Southern Trust to purchase the shareholders' stock; old debts were paid and closing costs were paid principally from Munford funds.

After analyzing the substance of this transaction, the court concludes that the Georgia distribution and share repurchase statutes are applicable to the present transaction. In so concluding, this court declines to follow C-T of Virginia, Inc. v. Barrett (In re C-T of Virginia, Inc.), 958, F.2d 606 (4th Cir. 1992). In that case, the Fourth Circuit held that a similar Virginia distribution statute did not apply to an LBO transaction. Id. at 610-11. The distribution and share repurchase statutes of the Georgia Code clearly were intended to protect creditors by prohibiting transfers at a time when a corporation is insolvent or would be rendered insolvent. Such intent furthers the longstanding principal that creditors are to be paid before shareholders. See Robinson, supra, 75 F.2d at 757.

Munford alleges that at the time of the LBO it was insolvent or thereby rendered insolvent. Two shell corporations (AAC and Wicker) with little or no assets,

negotiated the $71,800,000 Citicorp financing. A condition of the financing was that substantially all of Munford's assets were to be pledged to secure the financing. It was negotiated with the approval and assent of these defendants who were pre-merger directors of Munford. The nature and general terms of this financing was disclosed to the defendant directors and in Munford's LBO Proxy Statement. While the shareholder payments were not made until after the merger, the clear substance of this transaction was that Munford's pre-merger shareholders were to be paid from Munford funds. The fact that the LBO transaction was clothed in the guise of a merger does not change the fact that it may have effected an impermissible distribution or share repurchase under Georgia law. From the evidence, a jury could conclude that this was a distribution or share repurchase transaction. A jury could further conclude that by approving the Merger Agreement and consummating the LBO, the director defendants voted for or assented to this transaction. If the solvency issue is resolved in favor of Munford, there is no reason why these Georgia statutes should not apply. As noted above, genuine issues of fact exist with regard to whether Munford was rendered insolvent by the LBO transaction.

Defendants Carroll and Fellows, citing no authority, contend that they reasonably relied on their attorney's advice that the Georgia distribution and repurchase statutes did not apply to the LBO transaction. However, there is no language in these statutes which indicates that reliance on advice from an attorney is a defense to liability. The court concludes, therefore, that this contention is without merit.

Defendants Carroll and Fellows also contend that Munford's claim based on the Georgia distribution statute is barred by the statute of limitations. At the time of the Munford LBO, the statute of limitations with regard to bringing an action under O.C.G.A. § 14-2-91(a)(1) was six years.[30] As such, these claims were brought well within the six year period, and this contention is without merit. For the foregoing reasons, the court concludes that summary judgment in favor of the director defendants should be denied.

Accordingly, the court **RESPECTFULLY RECOMMENDS** to the district court the following:

> (1) that each of the separate motions for summary judgment filed by (a) DFA Entities; (b) Dillard Munford; (c) outside directors Blount, Dickson, Ferguson, Gardiner, LeBlond, Pearson, Rymer; (d) Rubel and Hardin; and (e) Carroll and Fellows should be **denied**;
>
> (2) that Carroll, Fellows, Hardin, and Rubel's motion to strike Munford's responsive statement of material facts should be **denied**;
>
> (3) that Munford's motion for partial summary judgment regarding certain affirmative defenses of defendants should be **denied**;
>
> (4) that Carroll, Fellows, Hardin, and Rubel's motion to strike the declaration of Neal S. Berinhout should be **granted**;

---

[30] O.C.G.A. § 14-2-154 (f) were superseded by O.C.G.A. § 14-2-832(c) on July 1, 1989. The revised statute shortened the statute of limitations period from six to two years.

(5) that Munford's motion to strike certain affirmative defenses of defendants should be **granted** with the following defenses to be stricken:

(a) the "unclean hands" defense set forth in the Sixth Defense of DFA Entities and the Eleventh Defense of Hardin and Rubel;

(b) the "waiver" defenses set forth in the Seventh Defense of Carroll, Fellows, Hardin, and Rubel; the Eighth Defense of Dillard Munford, Ferguson, Pearson, Blount, Dickson, Gardiner, LeBlond, Rymer, Hardin, and Rubel; and the Ninth Defense of Carroll and Fellows;

(c) the "in pari delicto" defense set forth in the Eleventh Defense of Hardin and Rubel;

(d) the "indispensable party" defense set forth in the Third Defense of Carroll and Fellows; the Seventh Defense of the DFA Entities; the Ninth Defense of Hardin and Rubel; the Twelfth Defense of Ferguson and Pearson; and the Thirteenth Defense of Dillard Munford, Blount, Dickson, Gardiner, LeBlond, and Rymer;

(e) the "TOC Retail Settlement Agreement" defense set forth in the Tenth Defense of Hardin and Rubel;

(f) the "Federal Rule of Civil Procedure 9(b)" defense set forth in the Sixth Defense of Carroll, Fellows, Hardin, and Rubel; and the Tenth Defense of Dillard Munford, Ferguson, Pearson, Blount, Dickson, Gardiner, LeBlond, and Rymer; and

(6) that Munford's motion to strike the Second Defense of the DFA Entities should be **denied**.

Pursuant to Federal Rule of Bankruptcy Procedure 9033(b), within ten (10) days after being served with a

copy of this opinion setting forth the court's proposed findings of fact and conclusions of law, a party may serve and file with the court clerk written objections which identify the specific proposed findings or conclusions objected to and state the grounds for such objection. The written objections shall specify with particularity the alleged error or errors made in the opinion. A party may respond within ten (10) days after being served with any such written objection. If no objections are filed, this opinion may be adopted as the opinion and order of the district court.

The clerk is directed to serve a copy of this Opinion upon plaintiff's and defendants' counsel.

IT IS SO ORDERED.

At Atlanta, Georgia, this 4th day of April, 1994.

/s/ Stacey W. Cotton
STACEY W. COTTON
UNITED STATES BANKRUPTCY JUDGE

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[Filed July 9, 1997]

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

No. 94-9046

MUNFORD, INC.,
a.k.a. Majik Market,

Debtor.

DANNE BROKAW MUNFORD, as Executrix of the Estate of Dillard Munford; JAMES M. CARROLL; RUSSELL FELLOWS; JOSEPH W. HARDIN; JAY RUBEL; WINSTON M. BLOUNT; HERBERT J. DICKSON; JAMES FERGUSON; ROBERT M. GARDINER; RICHARD K. LEBLOND; ANDRALL E. PEARSON; S. B. RYMER, JR.; SHEARSON LEHMAN BROTHERS, INC.; DFA INVESTMENT DIMENSIONS GROUP, INC.; STATE STREET BANK & TRUST COMPANY; PNC BANK, NATIONAL ASSOCIATION; BOSTON SAFE DEPOSIT TRUST COMPANY,

Plaintiffs-Appellees,

versus

VALUATION RESEARCH CORPORATION,

Defendant,

MUNFORD, INC.,

Defendant-Appellant.

On Appeal from the United States District Court
for the Northern District of Georgia

ON PETITION(S) FOR REHEARING AND
SUGGESTION(S) OF REHEARING EN BANC

(Opinion _____, 11th Cir., 19__, _____ F.2d _____).

Before: HATCHETT, Chief Judge, CLARK, Senior Circuit Judge, and MILLS*, District Judge.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no member of this panel nor other Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:

/s/ Joseph W. Hatchett
CHIEF JUDGE

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*Honorable Richard Mills, U.S. District Judge for the Central District of Illinois, sitting by designation.

ORD-42
(6/95)

Rule 29.6 List of Mutual Funds Managed by Petitioner

Petitioner, DFA Investment Dimensions Group Inc., is a mutual fund group, which includes the following mutual funds:

U.S. 9-10 Small Company Portfolio
U.S. 6-10 Small Company Portfolio
U.S. Large Company Portfolio
U.S. Small Cap Value Portfolio
U.S. Large Cap Value Portfolio
DFA Real Estate Securities Portfolio
Enhanced U.S. Large Company Portfolio
DFA One-Year Fixed Income Portfolio
DFA Two-Year Corporate Fixed Income Portfolio
DFA Two-Year Global Fixed Income Portfolio
DFA Two-Year Government Portfolio
DFA Five-Year Government Portfolio
DFA Intermediate Government Fixed Income Portfolio
VA Small Value Portfolio
VA Large Value Portfolio
VA Short-Term Fixed Portfolio
Japanese Small Company Portfolio
Pacific Rim Small Company Portfolio
United Kingdom Small Company Portfolio
Continental Small Company Portfolio
Large Cap International Portfolio
RWB/DFA International High Book to Market Portfolio
DFA International Small Cap Value Portfolio
DFA Global Fixed Income Portfolio
VA International Value Portfolio
VA International Small Portfolio
VA Global Bond Portfolio

International Small Company Portfolio
DFA Two-Year Global Fixed Income Portfolio
Emerging Markets Portfolio
Emerging Markets Small Cap Portfolio

Petitioner, PNC Bank N.A. is the Trustee for the trusts included in the DFA Group Trust. This trust group includes the following trusts:

6-7-8 Subtrust
Small Company Subtrust
6-10 Subtrust
DFA Fixed Income Subtrust
Small Cap Value Subtrust
Large Cap Value Subtrust
4-10 Value Subtrust

Petitioner, State Street Bank & Trust Company, is the Trustee for the 6-10 Subtrust (CalPers), which is part of the DFA Participating Group Trust.

Supreme Court, U.S.
FILED
NOV 25 1997
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1997

DFA INVESTMENT DIMENSIONS GROUP INC.,
STATE STREET BANK & TRUST COMPANY,
AND PNC BANK, N.A.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

DANNE´ BROKAW MUNFORD, as Executrix of The Estate of Dillard Munford; JAMES M. CARROLL; RUSSELL FELLOWS; JOSEPH W. HARDIN; JAY RUBEL; HERBERT J. DICKSON; ROBERT M.GARDINER; RICHARD K. LEBLOND, II; AND S.B. RYMER, JR.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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BRIEF IN OPPOSITION

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STATUTORY PROVISIONS INVOLVED

Section 546(e) of the Bankruptcy Code, 11 U.S.C. § 546(e) (1994), provides as follows:

§546 Limitations on avoiding powers.

(e) Notwithstanding sections 544, 545, 547, 548(a)(2), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title.

Section 741(8) of the Bankruptcy Code, 11 U.S.C. § 741(8) (1994), provides as follows:

§741 Definitions for this subchapter. In this subchapter--

(8) "settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.

Section 550(a) of the Bankruptcy Code, 11 U.S.C. § 550(a) (1994), provides as follows:

§550 Liability of transferee of avoided transfer.

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may

recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from --

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

Section 18-2-22(3) of the Official Code of Georgia Annotated, O.C.G.A. § 18-2-22(3) (1991), provides as follows:

The following acts by debtors shall be fraudulent in law against creditors and others and as to them shall be null and void:

(3) Every voluntary deed or conveyance, not for a valuable consideration, made by a debtor who is insolvent at the time of the conveyance.

STATEMENT OF THE CASE

Petitions separately filed by two groups of defendants[1]

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[1] Petitioners in **No. 97-550**, DFA Investment Dimensions Group, Inc. ("DFA"), State Street Bank & Trust Company and PNC Bank, N.A., are collectively referred to hereinafter as the "DFA Petitioners". Petitioners in **No. 97-591**, Danne' Brokaw Munford, as Executrix of the Estate of Dillard Munford, James M. Carroll, Russell Fellows, Joseph W. Hardin, Jay Rubel, Herbert J. Dickson, Robert M. Gardiner, Richard K. LeBlond, II and S.B. Rymer, Jr., are collectively referred to hereinafter as the "Director and Officer Petitioners". The DFA Petitioners and the Director and Officer Petitioners are collectively referred to hereinafter as "Petitioners". Because the Petition for Writ of Certiorari filed by the Director and Officer Petitioners (the "Director and Officer Petition") is, in substance, virtually identical to the Petition for Writ of Certiorari

seek this Court's review of the Eleventh Circuit Court of Appeals' decision that section § 546(e) of Title 11, United States Code (the "Bankruptcy Code"), 11 U.S.C. § 546(e) (1994), does not, on the facts of this case, shield from avoidance as a fraudulent conveyance the funds paid by respondent Munford, Inc. ("Munford") to its shareholders in connection with the leveraged buyout of its stock ("LBO").

Munford provides the following summary of proceedings and contextual facts that were not adequately presented in the Petitions.

A. Proceedings Below

Munford filed a petition for relief under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Georgia on January 2, 1990 (Case No. A90-00078). The bankruptcy filing occurred 13 months after Munford was acquired in an LBO, which closed on November 29, 1988. On June 17, 1991, acting as debtor in possession with the authority of a bankruptcy trustee pursuant to section 1107(a) of the Bankruptcy Code, 11 U.S.C. § 1107(a) (1994), Munford commenced this adversary proceeding in the bankruptcy court on behalf of the unsecured creditors injured by Munford's insolvency.

In Count I of its Amended Complaint (the only Count at issue here), Munford asserted fraudulent conveyance claims pursuant to federal law, section 544(b) of the Bankruptcy Code, 11 U.S.C. § 544(b) (1994), and Georgia law, O.C.G.A. § 18-2-22(3) (1991), against some of the shareholders who received LBO payments for their stock. Specifically, Munford sued its former officers and directors who received these payments (the

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filed by the DFA Petitioners (the "DFA Petition"), Munford hereby files a single Brief in Opposition to both the Director and Officer Petition and the DFA Petition (collectively, the "Petitions").

Director and Officer Petitioners) and its two largest, related, institutional shareholders (the DFA Petitioners).[2] Following lengthy discovery involving tens of thousands of documents and approximately 50 depositions, the Petitioners and other defendants filed motions for summary judgment in the bankruptcy court. On April 5, 1994, the bankruptcy court (Chief Judge Stacey W. Cotton) entered an order recommending to the United States District Court for the Northern District of Georgia, inter alia, that the summary judgment motions filed by the Petitioners with respect to Count I be denied.[3]

On August 10, 1994, the district court rejected the bankruptcy court's recommendation with respect to Count I and entered an order, inter alia, granting the summary judgment motions filed by the Petitioners, citing section 546(e) of the Bankruptcy Code.[4] On October 28, 1996, the Eleventh Circuit Court of Appeals reversed that decision, holding that section 546(e) of the Bankruptcy Code did not bar Munford's fraudulent conveyance claims on the facts of this case. Munford v. Valuation Research Corp. (In re Munford, Inc.), 98 F.3d 604, 609-10 (11th Cir. 1996).[5] On July 9, 1997, the Eleventh Circuit Court of Appeals entered an order denying the Petitioners' Petitions for Rehearing and Suggestions for Rehearing *En*

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[2] Under 11 U.S.C. § 544(b) (1994), a trustee [or, pursuant to 11 U.S.C. § 1107(a) (1994), a debtor in possession acting as a trustee] may avoid any transfer of the debtor that is voidable by an unsecured creditor under applicable law. Munford contends that the LBO payments the Petitioners received constituted fraudulent transfers under O.C.G.A. § 18-2-22(3) (1991), the applicable Georgia constructive fraudulent conveyance provision.

[3] The bankruptcy court's unreported opinion setting forth its recommendations is attached to the DFA Petition beginning at App. 52.

[4] The district court's unreported decision is attached to the DFA Petition beginning at App. 23.

[5] The Eleventh Circuit's decision is attached to the DFA Petition at App. 1.

Banc.[6]

B. Statement Of Facts

Before the LBO, Munford was an Atlanta-based, publicly traded company whose assets included a chain of Majik Market convenience stores and other retail chains. In late 1987, Munford's directors became interested in the possibility of selling the company. They retained Shearson Lehman Brothers Inc. ("Shearson") to evaluate Munford and to make recommendations regarding its future. In September 1987, Shearson presented a written financial report to the Director Petitioners that specifically recommended **against** an LBO or leveraged recapitalization. Shearson concluded that Munford could not carry the heavy debt load associated with a highly leveraged transaction in light of its financial condition and significant capital requirements.

Notwithstanding Shearson's express recommendation, the directors proceeded to approve just such a transaction with Deutschman & Co. ("Deutschman") in early 1988. Soon thereafter, however, Deutschman withdrew its LBO proposal after conducting its due diligence. Munford's directors were informed on March 3, 1988, that Deutschman, like Shearson, had concluded that Munford would not be able to repay the LBO debt that would be incurred and meet its capital requirements.

Following this aborted LBO proposal, Munford's financial condition continued to deteriorate. The company operated at a loss each month throughout 1988. In May 1988, however, the directors unexpectedly were presented with another LBO opportunity. Munford's board of directors,

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[6] The order denying the Petitions for Rehearing and Suggestions for Rehearing *En Banc* is attached to the DFA Petition at App. 112.

without reference to Shearson's earlier recommendation or Deutschman's conclusion, voted to accept this LBO proposal.

To effectuate the LBO, the acquiring group formed Alabama Acquisition Corporation ("AAC") and Alabama Merger Corporation ("AMC"), a wholly-owned subsidiary of AAC. Both AAC and AMC were shell corporations. Pursuant to the merger agreement, AMC and Munford were to merge, with Munford as the surviving corporation. On November 29, 1988, AAC acquired Munford for approximately $90 million. Substantially all of the money needed to fund the LBO came either from Munford's cash (and cash equivalents) or from a loan by Citicorp N.A. ("Citicorp") in excess of $53 million, for which all of Munford's assets were pledged as security.

In a series of simultaneous transactions, the LBO was consummated by merging AMC into Munford as the surviving corporation. As provided in section 3.1(a) of the merger agreement, all shares of Munford common stock owned by AMC were retired with no consideration exchanged for those shares. The remaining 3.9 million outstanding shares of Munford, including the shares owned by the Petitioners, were converted into the right to receive $17 per share. The funds to pay for these shares were deposited by Munford at Citizens & Southern Trust Company ("C&S"), to serve solely as "Paying Agent" (the title ascribed to it in the merger agreement). C&S, upon receipt of the tendered Munford shares, made the required payments to Munford's shareholders, including the Petitioners.

Munford was unable to meet its obligations, including paying the massive new debt to Citicorp, following the LBO. On January 2, 1990, 13 months after the LBO was consummated, Munford filed its petition for relief under Chapter 11 of the Bankruptcy Code.

C. The Court of Appeals Decision

The Eleventh Circuit Court of Appeals held that although C&S was a "financial institution," section 546(e) of the Bankruptcy Code does not shield from avoidance, as a fraudulent conveyance, the payments to the Petitioners in exchange for their Munford shares because the transfers were not made "by or to" C&S (or any other type of entity listed in section 546(e)). App. 12-13.[7] Because C&S was merely a conduit with no beneficial interest whatsoever in the funds passed by Munford through C&S to Munford's shareholders, the Eleventh Circuit held that the transfers were made "*by* Munford *to* shareholders." App. 12 (emphasis original).

REASONS FOR DENYING THE WRITS

The basis for the decision below undermines the Petitioners' request for review in this Court. Because the Eleventh Circuit Court of Appeals found it unnecessary to determine whether the payments to Petitioners in the Munford LBO constituted "settlement payments" within the meaning of section 546(e) of the Bankruptcy Code, a true and substantial conflict between the decision below and the Tenth Circuit Court of Appeals' decision in Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.), 952 F.2d 1230 (10th Cir. 1991), cert. denied, 505 U.S. 1213 (1992), is not presented. Confronted with this problem, the Petitioners' assert that an argument rejected by the Tenth Circuit in Kaiser nevertheless directly conflicts with an argument allegedly accepted by the Eleventh Circuit in this case, namely that, despite the language of the statute, the challenged transfer must be "to" one of the types of entities listed in the statute, irrespective of whether it is "by" one

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[7] Citations to "App. __" refer to the appendix attached to the DFA Petition.

of such entities. That, however, is not what the Eleventh Circuit held.

Not only have Petitioners failed to show a direct conflict between circuits, they also have failed to demonstrate any other compelling reason that would warrant this Court's review of the decision below. While the issues in this case are, of course, significant to the parties to the proceeding, the decision below does not present any clear opportunity for this Court, on review, to elucidate significant principles of fraudulent conveyance law.

Moreover, plainly, the Eleventh Circuit Court of Appeals in this case has not "so far departed from the accepted and usual course of judicial proceedings," Sup. Ct. R. 10(a), as to require this Court's review of its decision. Indeed, the Petitioners cannot demonstrate that the Eleventh Circuit's application of section 546(e) of the Bankruptcy Code to the facts of this case is incorrect. It is undisputed that section 546(e) was enacted to ensure the stability of the clearance and settlement system in the context of public transactions in the securities markets. Because the clearance and settlement system was entirely passive in this essentially private transaction between Munford and its shareholders, the overly expansive construction of section 546(e) urged by the Petitioners is improper.

I. Certiorari Is Not Warranted Because The Eleventh Circuit's Decision Does Not Directly And Substantially Conflict With The Tenth Circuit's *Kaiser* Decision.

The Petitioners incorrectly interpret the Eleventh Circuit's opinion as holding that section 546(e) is only applicable if the challenged transfer is made "to" one of the entities listed in that section (i.e., a transfer "by" such an entity is insufficient despite the express statutory language). DFA Petition at 10 ("[the Eleventh Circuit] erroneously held that Section 546(e) is only applicable to settlement payments made to one of the listed

entities.") (emphasis added); Director and Officer Petition at 9 (same). The Petitioners later interpret the Eleventh Circuit's opinion as holding that such transfers must be "by and to" one of the listed entities. DFA Petition at 18 (emphasis added); Director and Officer Petition at 14 (emphasis added). Neither interpretation is correct.

Though either of such conclusions might be in conflict with the reasoning of the Tenth Circuit in Kaiser, the Eleventh Circuit did not reach either of them. Rather, implicitly recognizing that the result cannot depend on the fortuitous circumstance of whether the object of the LBO itself writes the checks in payment to the shareholders or instead deposits the funds with a paying agent for administrative convenience, the Eleventh Circuit interpreted section 546(e) as inapplicable to mere conduits.

Thus, the Eleventh Circuit concluded that section 546(e) of the Bankruptcy Code was not implicated for reasons that were not even raised in the Tenth Circuit's Kaiser case. Specifically, the Eleventh Circuit found that the transfers in this case were not made "by or to" a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency:

> Here, the transfers/payments were made *by* Munford *to* shareholders. None of the entities listed in section 546(e) . . . made or received a transfer/payment. Thus, section 546(e) is not applicable.
>
> True, a section 546(e) financial institution was presumptively involved in this transaction. But [C&S] here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. The bank never acquired a beneficial interest in either the funds or the shares.

App. 12 (emphasis original). The Eleventh Circuit found support for its conclusion in cases uniformly holding that mere conduits are not deemed to be substantive participants in the process of transfer under a related provision of the Bankruptcy Code, section 550.[8] By analogy, the payments in this case would be deemed made by and to the real parties in interest -- Munford and the shareholders, respectively. Accord, Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.), 195 B.R. 971, 981-83 (Bankr. D. Mass. 1996).

As noted by the court in Healthco Int'l, 195 B.R. at 983, the Tenth Circuit in Kaiser did not consider the lack of beneficial interest by the intermediary, the argument apparently not having been raised. The Tenth Circuit's section 546(e) analysis in Kaiser focused instead on whether transfers made to selling shareholders in an LBO constituted "settlement payments" within the meaning of the statute. The Tenth Circuit concluded that they did. 952 F.2d at 1237-40. By contrast, the district court in Wieboldt Stores, Inc. v. Schottenstein, 131 B.R. 655, 663-65 (N.D. Ill. 1991), as well as the bankruptcy court in Healthco Int'l, 195 B.R. at 983, concluded that transfers made to selling shareholders in an LBO do not constitute "settlement payments" within the meaning of section 546(e) of the Bankruptcy Code.

This dispute, set up by the competing analyses in Kaiser and Wieboldt, has been the focus of numerous commentaries. Compare Neil M. Garfinkel, Note, No Way Out: Section 546(e) is no Escape for the Public Shareholder of a Failed LBO, 1991 Colum. Bus. L. Rev. 51; Gerald K. Smith and Frank R.

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[8] 11 U.S.C. § 550 (1994). See Nordberg v. Societe Generale (In re Chase & Sanborn Corp., 848 F.2d 1196, 1200 (11th Cir. 1988); Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988).

Kennedy, Fraudulent Transfers and Obligations: Issues of Current Interest, 43 South Carolina L. Rev. 709 (1992); William C. Rand, In re Kaiser Steel Corporation: Does Section 546(e) of the Bankruptcy Code Apply to a Fraudulent Conveyance Made in the Form of an LBO Payment?, 19 Fordham Urb. L. J. 87 (1991); and Jane Elizabeth Kiker, Judicial Repeal of Fraudulent Conveyance Laws: Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990), 14 Hamline L. Rev. 453 (1991) (all concluding that payments to selling shareholders in an LBO are not "settlement payments"), with Michael Cook, Brad J. Axelrod, and Geoffrey S. Frankel, The Judicially Created "Innocent Shareholder" Defense to Constructive Fraudulent Transfer Liability in Failed Leveraged Buyouts, 43 South Carolina L. Rev. 777, 801, 804 (1992) (finding Kaiser analysis "tenable," but noting that "insulating payments that are made to public shareholders from fraudulent transfer attack arguably does nothing to promote stability" in the clearance and settlement system).

The Eleventh Circuit's opinion in this case sidestepped this debate entirely. The Petitioners' statements that the Eleventh Circuit "found that the merger payments to shareholders constituted 'settlement payments' within the meaning of section 546(e)" are wholly inaccurate. DFA Petition at 12; Director and Officer Petition at 10. The Eleventh Circuit did not "find" that the LBO transfers were or were not "settlement payments" within the meaning of section 546(e). The court simply "presumed" that they were for the purpose of explaining its analysis on a different issue. App. 12. The Eleventh Circuit concluded on the facts of this case that "regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable". Id.

Thus, the opinion below does not directly and substantially conflict with the Tenth Circuit's opinion in Kaiser, or with any other lower court decision on the specific issue

considered and resolved in this case. Indeed, the decision below does not even address the central section 546(e) issue debated by the Tenth Circuit and other courts, and by commentators, when considering the application of the statute to alleged fraudulent conveyances made in connection with an LBO. Without any direct and substantial conflict between circuits, review in this Court simply is not warranted.

II. Certiorari Is Not Warranted Because The Eleventh Circuit's Decision Has Minimal Significance Beyond This Case.

In alarmist fashion, the Petitioners argue that if Munford may avoid, as fraudulent conveyances, the LBO payments made to them in this case, the knowledge of this avoidance would "undermine investor confidence in the financial markets." DFA Petition at 15; Director and Officer Petition at 13. This unabashed hyperbole, however, is rather persuasively undermined by the absence of any evidence that this case has had any appreciable effect whatsoever on **any** investor's confidence in the financial markets during its entire pendency.

Munford notes that on October 28, 1996, the day the Eleventh Circuit issued its opinion in this case, the Dow Jones Industrial Average closed at 5972. Less than one year later, on October 21, 1997, it closed at 8060, an increase of approximately 35%. In the three and one-half years since the bankruptcy court issued its proposed conclusion of law that section 546(e) does not shield fraudulent transfers in this case from avoidance, the Dow Jones Industrial Average has more than doubled. Perhaps more telling is the performance of the mutual funds managed by Petitioner DFA. A sampling of the first five of its mutual funds found on the list DFA provided pursuant to Sup. Ct. R. 29.6 (App. 113) reveals that the value of such funds since the Eleventh Circuit's decision has increased by approximately 36%. Since the bankruptcy

court's proposed conclusion of law, the value of such funds has increased by approximately 95%. Thus, the performance of DFA's own mutual funds contradicts its assertion that the Eleventh Circuit's decision will "undermine investor confidence in the financial markets." DFA Petition at 15. [9]

The Petitioners further argue that Munford's avoidance of the alleged fraudulent conveyances made to them in this case "would seriously disrupt [the clearance and settlement] system". DFA Petition at 15; Director and Officer Petition at 13. The clearance and settlement system, however, was only incidentally involved in the LBO that occurred in this case.

The court in Wieboldt explained generally how the clearance and settlement system works:

> Typically, when a customer wishes to buy a security, he or she places an order with his or her broker, who purchases the security from another broker, who is acting on behalf of a party who has placed an order to sell. Once the trade has been agreed upon, the process by which the security is delivered in exchange for the purchase price is known as "clearance and settlement." The clearing agency compares the trades its member brokers have made to arrive at an accounting of the day's transactions, which it then uses to establish each broker's money and securities settlement obligations. Finally, the trades are "settled" - funds and securities

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[9] The current and historical market figures cited above, which are adjusted for stock dividends and stock splits, were obtained from Dow Jones or TRADELINE news services. This Court can take judicial notice of these facts pursuant to Fed. R. Evid. 201(b)(2). See, e.g., In re Verifone Secs. Litig., 784 F. Supp. 1471, 1475 n.2 (N.D. Cal. 1992), aff'd, 11 F.3d 865 (9th Cir. 1993).

Although the world stock markets have dipped and fluctuated recently, Munford trusts that the Petitioners will not ask this Court to attribute such movements to this case.

are delivered in satisfaction of the obligations.

131 B.R. at 664 n.9 (citations omitted). Thus, in ordinary public transactions involving the purchase and sale of securities, the clearance and settlement system is necessary to match buyers with sellers and to provide an efficient means of accountability. The clearance and settlement system serves as an accountant, coordinator and guarantor.

Munford agrees with the Petitioners that it is this system of guarantees, within the ordinary course of the public securities market, that section 546(e) was designed to protect. In the Munford LBO, however, the clearance and settlement system was entirely passive and only incidentally involved. The public market for purchasing and selling securities simply was not used. As the Eleventh Circuit noted, the intermediaries served only as passive conduits for Munford's payment to the Petitioners. The intermediaries did not, and could not, make the guarantees that would be required if the transaction had been an open market trade -- the type of transaction that section 546(e) was intended to protect. As the bankruptcy court in this case observed:

> [T]his was essentially a private transaction between Munford and its shareholders. The public market for buying and selling securities was not meaningfully implicated. The clearance and settlement system was involved only to the extent that DFA [ ] used financial intermediaries to hold its Munford stock. In that instance, the system was merely used as a convenient conduit to surrender their shares and obtain payment of the LBO consideration.

App. 89.

The Petitioners provide no cogent explanation, nor offer any concrete example, of any injury that would be caused to the securities market clearance and settlement

system by the return of the LBO payments they received. Purely and simply, a judgment that requires Petitioners to return the LBO payments will cause no repercussions through the system and pose no threat whatsoever to its stability.

Finally, the DFA Petitioners assert that compelling them to return fraudulently conveyed funds now would affect their mutual fund shareholders who may not have been investors at the time of the LBO. The assertion may be correct,[10] but the risk is simply one of a panoply of risks that may affect the value of a mutual fund, and, surely, a much less significant risk than swings in the market generally. Moreover, in this case, the DFA Petitioners, like all other shareholders, were specifically warned in the LBO proxy statement that they might be required to return their LBO payments if a court determined that they were fraudulent conveyances.

The Petitioners' arguments regarding the effect of the decision below on the securities markets and the clearance and settlement system are vastly overstated, at best. This case does not present a compelling issue that warrants review.

III. Certiorari Is Not Warranted Because the Eleventh Circuit Properly Rejected Petitioners' Request For An Expansive Construction Of Section 546(e).

The Eleventh Circuit Court of Appeals in this case plainly has not "so far departed from the accepted and usual

[10] The DFA Petitioners' fund managers have their own worth, derived, for example, from administrative fees charged to their investors. There is no reason why the DFA Petitioners could not refund the LBO payments from their own resources, rather than passing the costs on to current investors.

course of judicial proceedings," Sup. Ct. R. 10(a), as to merit review in this Court. Indeed, the Petitioners cannot demonstrate that the Eleventh Circuit's application of section 546(e) of the Bankruptcy Code to the facts of this case is incorrect.

The DFA Petitioners assert that "the court of appeals incorrectly concluded that Section 546(e) only protects those types of entities specifically listed." DFA Petition at 17. This assertion reflects Petitioners' request, contrary to proper canons of statutory construction, for an expansive interpretation of the statute. Where, as here, the underlying law (fraudulent conveyance law) serves a broad **remedial** purpose,[11] any statutory exception to that remedy should be construed narrowly, rather than expansively. Piedmont & Northern Ry. v. Interstate Commerce Comm'n, 286 U.S. 299, 311-12 (1932).

Indeed, courts uniformly have held that exceptions to avoidance provisions in the Bankruptcy Code should be construed narrowly. See, e.g., Florida Steel Corp. v. Stober (In re Industrial Supply Corp.), 127 B.R. 62, 65 (M.D. Fla. 1991), aff'd, 961 F.2d 1582 (11th Cir. 1992) ("the court . . . should narrowly interpret [the § 547(c)(2) "ordinary course" exception to preference avoidance]"); J.P. Fyfe, Inc. of Fla. v. Bradco Supply Corp. (In re J.P. Fyfe, Inc. of Fla.), 96 B.R. 474, 476 (D. N.J. 1988), aff'd, 891 F.2d 66 (3d Cir. 1989) ("the court notes that it should not give untrammeled access to section 547(c)(2), but should construe the statute narrowly"); 222 Liberty Assocs. v. Prescott Forbes Real Estate Corp. (In re 222 Liberty Assocs.), 110 B.R. 196, 203 (Bankr. E.D. Pa. 1990) ("the exceptions [to avoidance of post-petition transactions] set forth in §§ 549(b) and (c) must be narrowly construed").

Further, the expansive construction of section 546(e)

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[11] See, e.g., In re Best Prods. Co., 168 B.R. 35, 57 (Bankr. S.D.N.Y. 1994), appeal dismissed, 177 B.R. 791 (S.D.N.Y.), aff'd, 68 F.3d 26 (2d Cir. 1995).

that Petitioners urge here, to support the statute's application to the facts of this case, would inappropriately and unnecessarily expand the scope of the statute beyond the transactions it was designed to protect. Section 546(e) was added by the 1982 Bankruptcy Amendments, Pub. L. No. 97-222, 96 Stat. 235 (the "1982 Amendments") to "clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market." H. Rep. No. 97-420 to accompany H.R. 4935, 97th Cong., 2d Sess. 1, 2 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583. The "commodities market protections" referred to were contained in section 764(c) of the Bankruptcy Code [the predecessor to section 546(e) which was simultaneously repealed with the enactment of section 546(e)]. Pub. L. No. 97-222 § 17(c). Section 764(c) was enacted in 1978 to prevent the result achieved in Seligson v. New York Produce Exch., 394 F. Supp. 125 (S.D.N.Y. 1975), where the court refused to find that a $12 million margin payment by a bankrupt commodities broker was exempt from the avoiding powers of the broker's trustee in bankruptcy. S. Rep. No. 95-989 at 106 (1978), reprinted in 1978 U.S.C.C.A.N. 5787. The House Report accompanying the Bankruptcy Code addressed section 764(c) as follows:

> Subsection (c) insulates variation margin payments and other deposits from the avoiding powers except to the extent of actual fraud under section 548(a)(1). This facilitates prepetition transfers and protects the ordinary course of business in the market.

H. Rep. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. 392 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6348 (emphasis added). As noted above, section 764(c) was repealed simultaneously with the enactment of section 546(e) by the 1982 Amendments. The stated purpose of the 1982 Amendments was "to minimize the displacement caused in the commodities and

securities markets in the event of a major bankruptcy affecting those industries." H. Rep. No. 97-420 to accompany H.R. 4935, 97th Cong., 2d Sess. 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583. The House Report summarized the bill as follows:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature [of] the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.
>
> The Bankruptcy Code now expressly provides certain protections to the commodities market to protect against such a "ripple effect." One of the market protections presently contained in the Bankruptcy Code, for example, prevents a trustee in bankruptcy from avoiding or setting aside, as a preferential transfer, margin payments made to a commodity broker (see 11 U.S.C. Sec. 764(c)).
>
> The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market.

Id. at 1, 2, 1982 U.S.C.C.A.N at 583.

This legislative history of section 546(e) (including the legislative history of its predecessor, section 764(c)) indicates that it was not the players in the clearance and settlement system that needed protection, but the system itself. See Wieboldt, 131 B.R. at 665 ("[it was] the system which Section 546(e) was designed to protect"). An understanding of this clearance and settlement system coupled with the legislative purpose of section 546(e) establish that section 546(e) was not intended to

encompass payments to shareholders through passive intermediaries in LBO transactions. Section 546(e), therefore, should not apply where, as in this case, the clearance and settlement system that it was designed to protect is only incidentally involved in the particular transaction, and there was not even a remote threat of any insolvency involving a commodities or securities firm that might ripple through the clearance system for securities transactions.

While the goal of section 546(e) -- protection of the securities market clearance and settlement system -- is not advanced by precluding fraudulent conveyance liability in this case, the remedial goal of fraudulent conveyance law -- the fair treatment of unsecured creditors -- would be wholly frustrated by insulating the transactions at issue. As the Third Circuit Court of Appeals observed in Moody v. Security Pac. Business Credit, Inc., 971 F.2d 1056, 1073 (3d Cir. 1992), "[a]t least from the viewpoint of the unsecured creditor, leveraged buyouts present great potential for abuse." Id. at 1073. The court concluded: "we believe failed leveraged buyouts merit close scrutiny under the fraudulent conveyance laws." Id. Similarly, the court in Crowthers McCall Pattern, Inc. v. Lewis, 129 B.R. 992, 997-98 (S.D.N.Y. 1991), stated: "[a] leveraged buy out ... can harm creditors in exactly the way fraudulent conveyance laws are designed to prevent." 129 B.R. at 998. The Eleventh Circuit's determination that section 546(e) should not and does not bar fraudulent conveyance recovery in this case was correct.

Finally, the DFA Petitioners' appeal to equity, arguing that avoidance of the alleged fraudulent conveyance they received would be unfair because they were only passive participants in the LBO, is unavailing. Their equitable appeal, even if it were supportable, is irrelevant, both because it does not raise a compelling issue for review in this Court and because the intent or knowledge of the recipient of the conveyance is irrelevant in a constructive fraudulent conveyance action. See

Brown v. Citizens & Southern Nat'l Bank, 317 S.E.2d 180, 183 (Ga. 1984); Leachman v. Cobb Dev. Co., 172 S.E.2d 688, 689 (Ga. 1970).

Moreover, the DFA Petitioners' equitable appeal, even if it were relevant, is unsupported by the facts of this case. The proxy statement distributed to the DFA Petitioners in connection with the proposed LBO provided extensive information regarding the highly leveraged nature of the proposed transaction and the significant financial risks to Munford. Indeed, in two separate sections (including the introductory "Summary"), the LBO proxy statement **specifically disclosed the risk of a fraudulent conveyance action** that might "require that former shareholders of the Company return" the payments received for their shares in connection with the LBO. Nevertheless, Munford's board of directors (including each of the Director Petitioners), under whose supervision the LBO proxy statement was prepared, and the DFA Petitioners (highly sophisticated institutional investors) voted to approve the LBO. Unlike the Petitioners, Munford's unsecured creditors injured by the LBO, including worker's compensation claimants and convenience store property lessors, had no opportunity to vote for or against the transaction. In light of the vast injuries sustained by unsecured creditors who were left with claims worth pennies on the dollar, the Petitioners' appeal to fairness is hollow.

CONCLUSION

The Petitioners' arguments that the court of appeals misapplied section 546(e) of the Bankruptcy Code to the facts of this case would not warrant review in this Court even if the arguments were correct. The Petitioners have not demonstrated any compelling cause for this Court to exercise its discretion to grant the Petitions. Accordingly, the Petitions should be denied.

Dated: November 25, 1997.

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Nos. 97-550 and 97-591

In the Supreme Court of the United States

OCTOBER TERM, 1997

DFA INVESTMENT DIMENSIONS GROUP INC., ET AL., PETITIONERS

v.

MUNFORD, INC.

DANNE' BROKAW MUNFORD, ETC., ET AL., PETITIONERS

v.

MUNFORD, INC.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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1288

QUESTION PRESENTED

Whether payments made to and by a bank that acts as an exchange agent for a corporate merger transaction are "transfers" that may be protected, under 11 U.S.C. 546(e), from avoidance and recovery in a subsequent bankruptcy proceeding involving the corporation that survived the merger.

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ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-22)[1] is reported at 98 F.3d 604. The opinions of the district court (Pet. App. 23-51) and the bankruptcy court (Pet. App. 52-110) are unreported.

[1] References are to the appendix to the petition in No. 97-550.

JURISDICTION

The judgment of the court of appeals was entered on October 28, 1996. A petition for rehearing was denied on July 9, 1997. The petitions for a writ of certiorari were filed on September 26, 1997 (No. 97-550) and October 3, 1997 (No. 97-591). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Respondent Munford, Inc. operated three chains of specialty and convenience stores. Pet. App. 2. Before the transaction at issue in this case, respondent's shares were publicly held and listed on the New York Stock Exchange. *Id.* at 4-5 & n.1. In November 1988, an investor group acquired all of respondent's outstanding shares in a transaction, approved by respondent's 3,100 shareholders, in which each of the 3.9 million shares not already held by the new investors was converted into a right to receive a cash payment of $17 per share. *Id.* at 4-5, 59. To effectuate the transaction, respondent and the new investor group borrowed and deposited the necessary funds with a bank, which then made appropriate payments to respondent's shareholders in exchange for their shares. *Id.* at 4, 10, 12, 81-82.

Thirteen months after the transaction, respondent filed for bankruptcy. Pet. App. 5. As part of its bankruptcy case, respondent filed an adversary proceeding seeking to recover, as voidable transfers, payments totalling approximately $10.8 million made, in the buy-out transaction, to two groups of former shareholders, including a group of related pension-fund investors (petitioners in No. 97-550) and certain former officers and directors of respondent (petitioners in No. 97-591). *Id.* at 5-6.

Petitioners moved for summary judgment in the adversary proceeding on the ground that 11 U.S.C. 546(e) precluded recovery of the payments in question. Under Section 546(e), a trustee or debtor-in-possession may not, in the absence of proof of actual intent to defraud creditors, "avoid a transfer that is a * * * settlement payment, as defined in section * * * 741 * * *, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency." Section 741 of the Bankruptcy Code, 11 U.S.C. 741, defines the term "settlement payment" to mean any of a variety of types of settlement payment "or any other similar payment commonly used in the securities trade."

The bankruptcy court concluded that petitioners' motions for summary judgment should be denied. Pet. App. 6-7, 81-91. The district court, however, held that petitioners were entitled to summary judgment on their claim that Section 546(e) barred recovery. *Id.* at 32-37. On appeal to the Eleventh Circuit, the Securities and Exchange Commission filed a brief arguing that the district court's decision on the Section 546(e) issue should be affirmed.[2]

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[2] The Commission participated in this case pursuant to 11 U.S.C. 1109(a), which provides that the Commission "may raise and may appear and be heard on any issue in a case under" Chapter 11 of the Bankruptcy Code, 11 U.S.C. 1101 *et seq.* The Commission acts as an advisor to the court and seeks primarily to protect the interests of public investors. Although the Commission may not file its own appeals under Section 1109(a), it may appear in appeals brought by other parties, as it did in this case. The Commission also filed a brief supporting petitioners' request for rehearing and suggestion of rehearing en banc in the court of appeals.

The court of appeals reversed the district court's decision construing Section 546(e). Pet. App. 1-13, 20. The court acknowledged that the bank that acted as exchange agent in the buy-out transaction was a "financial institution" for purposes of that Section, and it "presume[d]" that the payments in question were "settlement payments." *Id.* at 12. The court held, however, that the transaction had involved no "transfer" made "by or to" the bank for purposes of Section 546(e), because the bank served as "nothing more than an intermediary or conduit" for transfers or payments "made *by* [respondent] *to* shareholders." *Ibid.* In the court's view, because the bank "never acquired a beneficial interest in either the funds or the shares" exchanged in the transaction, "it was not a 'transferee'" of respondent's funds; the only "transferees" were respondent's former shareholders, and "section 546(e) offers no protection * * * to shareholders." *Id.* at 12-13.

Chief Judge Hatchett dissented from the court's holding under Section 546(e). Pet. App. 21-22. In his view, the court had "chose[n] to disregard the plain language of section 546(e) in order to create a new exception to its application." *Id.* at 22. He would instead have held that the payments in question were "settlement payments" made to shareholders by a "financial institution," and were therefore protected by Section 546(e). *Ibid.*

ARGUMENT

1. In the absence of proof of actual intent to injure creditors, 11 U.S.C. 546(e) precludes the avoidance in bankruptcy of any "transfer" that is a "settlement payment" made "by or to" a participant in the national securities clearance and settlement system. Section

101(54) of the Bankruptcy Code defines the term "transfer" to include "every mode * * * of disposing of or parting with property or with an interest in property." 11 U.S.C. 101(54). Congress intended that term to be "as broad as possible"; and "any * * * transfer of possession, custody, or control [is a transfer] even if there is no transfer of title, because possession, custody, and control are interests in property." S. Rep. No. 989, 95th Cong., 2d Sess. 27 (1978); H.R. Rep. No. 595, 95th Cong., 1st Sess. 314 (1977). In this case, therefore, there was a "transfer" of cash by respondent to the bank as exchange agent for the buy-out transaction, and a further "transfer" by the bank to respondent's former shareholders, including petitioners.

The court of appeals held, to the contrary, that there was no "transfer" in this case because "[t]he bank never acquired a beneficial interest in either the funds or the shares." Pet. App. 12. That rationale (which the court adopted sua sponte, without the benefit of briefing or argument) finds no support in the language or purposes of Section 546(e). Indeed, Section 546(e) was enacted in order to protect entities that act as "conduits" between buyers and sellers in clearing and settling millions of securities transactions every year, as well as the buyers and sellers themselves, from the uncertainty and disruption in the securities markets that could otherwise be caused by the risk or actuality of bankruptcies affecting market participants.[3] Holding Section 546(e) inappli-

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[3] Section 546(e)'s statutory predecessor was enacted in 1978 to rectify problems caused in the commodities markets by the decision in *Seligson* v. *New York Produce Exchange*, 394 F. Supp. 125 (S.D.N.Y. 1975), in which the trustee for a bank-

cable to payments made by or to brokers, clear-ing agencies, or financial institutions whenever they could be characterized as acting as "conduits," rather than as principals, would largely nullify the statute.[4]

2. The decision below rests on an interpretive error that may at some point call for this Court's review and correction. In our view, however, the matter is not presently ripe for review.

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rupt commodities broker sought to avoid and recover $12 million in margin payments that the broker had made to a commodities clearing association. The association contended that it could not properly be considered the transferee of the margin payments, because it was acting only as a "conduit." The district court denied the association's motion for summary judgment. Congress's response to the uncertainty engendered by that decision was to enact 11 U.S.C. 764(c) (Supp. II 1978), which protected commodities margin and settlement payments from being recovered as fraudulent transfers or preferences. See S. Rep. No. 989, *supra*, at 106. Section 546(e), enacted in 1981, extends that protection to include the securities markets.

[4] The court misplaced reliance (Pet. App. 12) on *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200-1201 (11th Cir. 1988). That case held that a bank was not, on particular facts, an "initial transferee" from whom a trustee could actually recover, under 11 U.S.C. 550(a), a transfer that the court assumed (see 848 F.2d at 1198-1199) was properly avoidable under the substantive fraudulent conveyance rules of 11 U.S.C. 548. The issue in this case is whether a very different sort of transfer may properly be avoided under the substantive rule of Section 546(e). It would be ironic to apply a principle developed to protect financial institutions from recovery as "transferees" under Section 550(a) to prevent the same institutions from obtaining the benefit of Section 546(e), which was enacted specifically in order to protect them in situations in which their primary role is to faciliate the operation of the securities markets by acting as secure and neutral "conduits" in the execution of transactions among arm's-length buyers and sellers.

Petitioners contend (97-550 Pet. 10-12; 97-591 Pet. 9-11) that the decision in this case conflicts with the Tenth Circuit's decision in *Kaiser Steel Resources, Inc.* v. *Pearl Brewing Co.*, 952 F.2d 1230 (1991), cert. denied, 505 U.S. 1213 (1992). It is fair to say that the two cases involved similar facts, and that the courts reached different conclusions about whether Section 546(e) precluded the avoidance and recovery of payments made by a corporation to former shareholders in a buy-out merger. The decisions are, however, analytically distinct.

Kaiser Steel held principally—and correctly—that buy-out payments made to former shareholders through one of the intermediaries listed in Section 546(e) are "settlement payments" for purposes of that provision. 952 F.2d at 1236-1240; see 91-1607 S.E.C. Br. in Opp. 7-13. The court of appeals in this case appeared to agree with that holding, although it declined to pass on the issue, instead "presum[ing]" that the payments in question were "settlement payments." Pet. App. 10-12 & n.4. The court below based its refusal to apply Section 546(e) on the quite different ground that the payments at issue in this case involved no "transfer" of funds to or from the exchange-agent bank, because the bank acted only as a "conduit," and "never acquired a beneficial interest in either the funds or the shares." *Id.* at 12. That question was not raised or decided in *Kaiser Steel*.[5]

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[5] Indeed, the financial institution defendants in *Kaiser Steel* were ones that *did* beneficially own the Kaiser shares that they tendered, and for which they received payment, in the transaction at issue in that case. See 952 F.2d at 1236. Another case arising from the Kaiser Steel transaction, *Kaiser Steel Corp.* v. *Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990), held Section 546(e) applicable to payments made to a broker that

As we have discussed, the court of appeals' restrictive interpretation of the word "transfer" in Section 546(e) is incorrect. If widely adopted and applied, it could undermine the effectiveness of Section 546(e) in achieving Congress's purpose of protecting participants in the securities clearance and settlement system and the stable and efficient functioning of the securities markets. That purpose is best achieved by safeguarding settlement payments, under most conditions, from avoidance and recovery in the event of bankruptcy on the part of any party or intermediary involved in the transaction. Nonetheless, the court of appeals adopted its novel theory without the benefit of briefing and argument, and the matter has not been addressed by any other court of appeals. Review by this Court at the present time would therefore be premature.

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acted solely as an intermediary in the transaction. In that case, the intermediary made an argument similar to the theory adopted by the court of appeals in this case—that it functioned solely as a "conduit" and therefore should not be treated as a "transferee" under 11 U.S.C. 550(a). 913 F.2d at 848; see also note 4, *supra*; *Kaiser Steel*, 952 F.2d at 1236. The *Schwab* court did not, however, reach the "conduit" argument. 913 F.2d at 848.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1997

DFA INVESTMENT DIMENSIONS GROUP INC., STATE STREET BANK & TRUST COMPANY, and PNC BANK, N.A.,

Petitioners,

v.

MUNFORD, INC.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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Petitioners file this Reply Brief to deal with issues first raised in the Briefs in Opposition filed by Munford, Inc. ("Munford") and the United States Securities and Exchange Commission ("SEC").

I.

The Eleventh Circuit's Decision Is In Direct Conflict With The Tenth Circuit's *Kaiser Steel* Decision And Is Ripe For Review

Munford argues that this Court should not grant certiorari because the Eleventh Circuit's decision below does not "directly and substantially" conflict with the Tenth Circuit's decision in *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992). Munford, however does not deny that the *Kaiser Steel* decision and the instant case: (i) both involved the same type of merger, the same type of defendants, and the same type of plaintiff, (ii) construed the same provision of the Bankruptcy Code, Section 546(e); and (iii) reached directly opposite results. The SEC is even more forthcoming in its Brief in Opposition, acknowledging that "the two cases involved similar facts" and that "the courts reached different conclusions about whether Section 546(e) precluded the avoidance and recovery of payments made by a corporation to former shareholders in a buy-out merger." SEC Brief in Opposition 5.

Despite this undeniable conflict in result, both Munford and the SEC argue that this Court should not review this case because the two courts of appeals applied different reasoning in reaching their different results. A comparison of the issues and holdings of the two decisions demonstrates the error in this argument. At issue

before the two courts of appeals were decisions of district courts holding that Section 546(e) barred avoidance of LBO payments. *Kaiser Steel*, 942 F.2d at 1235; *Munford v. Valuation Research*, Pet. App. 10. In *Kaiser Steel*, the Tenth Circuit described its holding as follows: "We agree and, therefore, affirm the judgment of the district court." 952 F.2d at 1235. Conversely, the Eleventh Circuit concluded: "section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities. We conclude the district court erred with respect to this issue and reverse." Pet. App. 13.

Thus, each court addressed the same issue: whether the district court had properly applied Section 546(e) to exempt LBO payments from a trustee's (or debtor in possession's) avoidance powers. The courts answered this question differently, creating a direct conflict. The fact that the Tenth Circuit did not expressly address the Eleventh Circuit's reasoning that LBO payments are not "transfers" is irrelevant because the Tenth Circuit could not have reached its decision without rejecting this position. By its express terms, Section 546(e) only applies to a "transfer that is a . . . settlement payment." 11 U.S.C. §546(e). Therefore, in order for the Tenth Circuit to have held that LBO payments are exempt under Section 546(e), the court must have found that such payments were "transfers", rejecting the Eleventh Circuit's position. This extreme divergence in result and reasoning supplies an additional reason to grant the writ, so that this Court can supply needed guidance to the lower courts in the proper application of the statute.

The SEC, which supported Petitioners below, continues to agree with Petitioners that the Eleventh Circuit wrongly decided the case. SEC Brief in Opposition 8

("court of appeals' restrictive interpretation of the word 'transfer' in Section 546(e) is incorrect"). The SEC also recognizes that the decision below rests on an erroneous interpretation of Section 546(e) which calls for this Court's correction. SEC Brief in Opposition 6. Nonetheless, the SEC suggests that review by this Court is not necessary because "the matter is not presently ripe for review." *Id.* This argument suffers from the same infirmities as Munford's position. The instant case satisfies the criteria of this Court's Rule 10 because the Eleventh Circuit's decision is "in conflict with the decision of another United States court of appeals" on—by the SEC's own admission—the same important issue of federal statutory law. Nothing in the Rule 10, sound practice, or common sense would require that two lower courts use precisely the same analysis in reaching their opposing conclusions. A direct conflict exists because two courts of appeals applied precisely the same provision of the Bankruptcy Code to two virtually identical mergers and reached directly opposite conclusions.[1]

II.

This Case Involves An Important Issue of Federal Law

Munford erroneously argues that this case does not involve an important question of federal law and discounts the risk that recovery of payments for stock years

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[1] The SEC also argues that review by this Court is not warranted because the court below adopted its novel theory without benefit of briefing and argument. This circumstance provides no reason not to issue the writ, because the matter involves an important issue, as the SEC itself recognizes, and can be briefed and argued in this Court.

after the transaction may undermine confidence in the securities markets. Munford relies on the fortuitous rise in the stock market since the decision of the court below. This fortuitous circumstance does not detract from the fact, emphasized by the SEC in this Court and in the court below, that if the decision of the Eleventh Circuit were widely adopted and applied, it could undermine the effectiveness of Section 546(e) in achieving Congress' purpose of protecting participants in the securities clearance and settlement system and the efficient functioning of the securities markets. *See* SEC Brief in Opposition 8.

In fact, the issues raised in this case have potential application to every merger transaction involving public companies in the United States. The potential always exists that the merged company will not be successful, will declare bankruptcy and that a trustee will use a fraudulent conveyance theory to attempt to recover payments from former shareholders for their stock. While this circumstance does not occur every day, a major bankruptcy could cause serious disruption of the securities markets, a primary reason that Congress passed Section 546(e). The point, recognized by the SEC, is that a rule of law which permits a trustee in bankruptcy, years after the sale of stock, to unwind settled securities transactions by recovering payments made to shareholders in a public merger transaction could destabilize the clearance and settlement system. This circumstance is the exact result Section 546(e) was intended to avoid. A bankruptcy of a major player in the system clearly could negatively affect the entire system and it makes no difference whether the participant is a stockbroker, financial institution or customer. The failure of one participant, such as a customer, to fulfill its obligations can

cause others in the settlement process to be unable to meet their requirements, causing a failure of the entire system. Contrary to Munford's argument, it makes no difference whether the settlement and clearance system was directly or tangentially involved in the merger transaction. Section 546(e) protects the "system" by protecting transfers that are settlement payments made by or to one of the listed entities.

III.

Section 546(e) Should Be Applied According To Its Plain Meaning

In arguing that the Eleventh Circuit's decision is correct, Munford erroneously asserts that Petitioners urge an expansive interpretation of Section 546(e) which would not be appropriate to its purpose of protecting the nation's securities markets. Petitioners, however, seek only to have the statute applied according to its plain meaning. Section 546(e) by its terms prevents a trustee in bankruptcy or debtor in possession from recovering settlement payments such as those in this case, that were made either "by or to" one of the listed entities, except in cases involving actual fraud. Applying the statute according to its clear and unambiguous terms will provide certainty that settled securities transactions would not be reversed and thereby further Congress' general purpose to protect the nation's financial markets from instability caused by bankruptcies. *See* DFA Petition 19-24. In this regard, the SEC continues to support Petitioners, noting that the court of appeals' rationale "finds no support in the language or purposes of Section 546(e)", SEC Brief in Opposition 5, and that the "court of

appeals' restrictive interpretation of the word transfer is incorrect". SEC Brief in Opposition 8.

The Eleventh Circuit's decision regarding the proper application of Section 546(e) ignores the plain language of the statute and directly conflicts with the Tenth Circuit's decision. This Court should grant the petition to resolve this conflict on an important issue of federal law.

Respectfully submitted,

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